

NYSBA

**2004 Antitrust Law
Section Symposium**

January 29, 2004

New York Marriott Marquis

NEW YORK STATE BAR ASSOCIATION
ANTITRUST LAW SECTION

ANNUAL MEETING

Thursday, January 29, 2004
New York Marriott Marquis
New York City

Section and Program Chair
BARBARA ANTHONY, ESQ.
Regional Director, Northeast Region
Federal Trade Commission
New York City

Dinner Speaker
TIMOTHY J. MURIS
Chairman
Federal Trade Commission
Washington, D.C.

TABLE OF CONTENTS

INTRODUCTORY REMARKS	1
-----------------------------------	----------

Barbara Anthony, Esq.

ANNUAL REVIEW OF ANTITRUST DEVELOPMENTS.....	2
---	----------

William T. Lifland, Esq.
Cahill, Gordon & Reindel
New York City

Molly S. Boast, Esq.
Debevoise & Plimpton
New York City,
Former Director
Bureau of Competition
Federal Trade Commission

RECENT DEVELOPMENTS INVOLVING STATE ACTION DOCTRINE, NOERR-PENNINGTON, AND THE HEALTH CARE INDUSTRY.....	8
---	----------

Panel Chair: **Ilene Knable Gotts, Esq.**
Wachtell, Lipton, Rosen & Katz
New York City

Panelists: **John Delacourt, Esq.**
Chief Antitrust Counsel
Office of Policy Planning
Federal Trade Commission
Washington, D.C.

Margaret E. Guerin-Calvert
President and Managing Director
Competition Policy Associates
Washington, D.C.

Constance K. Robinson, Esq.
Kilpatrick Stockton LLP
Washington, D.C.,
Former Director
Civil Enforcement and Operations
Antitrust Division
United States Department of Justice

Toby G. Singer, Esq.
Jones Day
Washington, D.C.

ANTITRUST INJURY PANEL22

Panel Chair: **David M. Hayes, Esq.**
Bond, Schoeneck & King, PLLC
Syracuse, New York

Panelists: **John M. Desiderio, Esq.**
John M. Desiderio, P.C. & Associates
New York City

Dr. Janusz A. Ordover
Professor of Economics
New York University,
Director
Competition Policy Associates
Washington, D.C.

William H. Rooney, Esq.
Wilkie Farr & Gallagher LLP
New York City

SECTION BUSINESS MEETING33

**OVERVIEW AND ECONOMIC ANALYSIS
OF THE RECENT MASTERCARD/VISA CASE34**

Panel Chair: **Lloyd Constantine, Esq.**
Constantine & Partners
New York City

Panelists: **Dr. Franklin Fisher**
Carlton Professor of Microeconomics
Massachusetts Institute of Technology,
Charles River Associates
Boston, Massachusetts

Dr. Eric Emch
Economist
Antitrust Division
United States Department of Justice

Dr. Janusz A. Ordover
Professor of Economics
New York University,
Director
Competition Policy Associates
Washington, D.C.

ANTITRUST DINNER51

Service Award Recipient:
Lloyd Constantine
Constantine & Partners
New York City

Dinner Speaker:
Timothy J. Muris
Chairman, Federal Trade Commission
Washington, D.C.

Introduction

MS. ANTHONY: Good morning, everyone. I'm Barbara Anthony, the Section Chair and Chair of today's program. I want to welcome all of you to our all-day CLE program. I hope that you will find our program interesting and challenging and engaging. I can assure you we have assembled a very distinguished group of program chairs and panelists, and the topics are very, very timely. Some of them are provocative, and I think you're going to enjoy the day. We also plan to have a lot of interaction between panelists and those attending.

I also hope that you will be able to spend the entire day with us and come to our cocktail reception later on this afternoon, and our dinner this evening, which features our keynote speaker—Tim Muris, Chairman of the Federal Trade Commission. So we do have great day planned, and I want to welcome all of you.

Let me also mention that for those of you who are Section members, at the end of our last panel this morning, at 12:45, there will be a brief annual business meeting of Section members and that will take place in this room. And that will be at 12:45 today.

We have three panels this morning. The first panel is our traditional kickoff to this event, which is an overview of recent antitrust law developments. We are very fortunate to have both Bill Lifland and Molly Boast joining us this morning on this panel. Let me introduce them to you. Although I know that they need no introduction, nonetheless I'm going to go ahead and introduce them and tell you a little bit about their backgrounds.

Molly Boast is a partner at Debevoise & Plimpton. She's a member of the firm's litigation department and focuses on antitrust and other complex litigation, merger analysis and a wide range of antitrust counseling.

Now, Ms. Boast, as all of you know, is the former Director of the Bureau of Competition at the Federal Trade Commission. Prior to that she was the Senior Deputy Director. During her tenure at the Commission she had principal responsibility for some pretty high profile cases, BP/ARCO, Heinz/Beechnut mergers and a number of other very high profile merger cases at that

time during the height of the merger wave. She also served as the AG's representative to the joint European Union/FTC/Department of Justice Mergers Working Group. And something that I didn't know about her background is that she had been appointed in the early '90s Special Assistant United States Attorney for the Independent Counsel Investigation of Banca Nazionale del Lavoro, "Iraqgate."

I would like to have coffee over that one some time.

She speaks and writes extensively in the area of antitrust law. She is also very active in pro bono activities and has held directorships in several New York City public interest organizations.

She has a J.D. from Columbia University Law School, a Harlan Fiske Stone Scholar. She also has a master's degree from Columbia University School of Journalism and a B.A. from the College of William & Mary with honors.

Her partner this morning, Mr. William Lifland, is a graduate of Yale University. He was a member of Phi Beta Kappa there and received his legal training at Harvard Law School, where he was president of the *Harvard Law Review*. Following his graduation, he entered military service and later served as clerk to Associate Justice John M. Harlan of the United States Supreme Court.

After beginning practice with the firm of Cahill Gordon, he spent two years at the firm's office in Paris, and then he rushed to New York where he began specializing in antitrust and intellectual property law. He's been the Chairman of the Section of Antitrust Law of our New York State Bar Association and a member of the Council of the Antitrust Section of the American Bar Association.

He's currently an Adjunct Professor of Law at Fordham Law School; the author of numerous articles and publications, including *State Antitrust Law*; and a co-author of the text, *Understanding the Antitrust Laws*.

He is a long-standing member of our committee. We are very happy to have both Molly Boast and Bill Lifland with us this morning to talk about what's been going on in our field of law over the past year. So, Molly and Bill.

Annual Review of Antitrust Developments

MR. LIFLAND: Good morning ladies and gentlemen. Molly Boast and I are going to summarize for you what one or the other of us considers as the more significant antitrust rulings of 2003. We will obviously be unable to cover all the significant cases orally, and will focus instead on a few of the more interesting ones. The written material includes citations to most of these, together with brief summaries. If you have this material before you, it should make it easier to follow the discussion.

Let me apologize in advance if your favorite cases, especially your victories, are omitted, not covered as fully as they deserve, or even worse, not covered accurately.

A Supreme Court case came down in mid-January, after the outline went to press. That was the *Verizon Communications* case. The Court held that the Second Circuit erred in reversing the trial court's dismissal of the antitrust claims. Put more briefly, the Supreme Court said the antitrust claims were unfounded as pleaded. This decision will be taken up in more detail later.

First, I will try to cover decisions involving Section 1 and Section 2 issues. An effort will be made to avoid subjects that are being covered by other panels, but some overlap is unavoidable.

Initially, we take up collective action. We all know that more than merely single-firm activity is needed to violate Section 1 of the Sherman Act.¹ This appears from the wording of the statute itself—which applies to contracts, combinations or conspiracies—and from its interpretation in the *Copperweld*² case, among others. It comes as no surprise then to see rulings turning on presence or absence of collective action in Section 1 cases. Collective action may exist without uniformity. The *Wilhelmina Model* case³ illustrates the point. For an unlawful conspiracy to be found, it was enough for model agencies to put up their charges to models by agreement starting from a higher level; the charges did not have to be increased to the same amount.

Some minimum degree of jointness is necessary, however.

In *InterVest*⁴ this minimum was communication with a common interest. The *Baker* and *Williamson* cases⁵ use the familiar metaphor of parallel conduct. The courts often state that such conduct should not be found collective when non-conspiratorial explanations for the parallelism are equally likely. Professor Handler used to ask his students whether conspiracy was indicated if the entire class stood on the steps of the law school and opened their umbrellas. The answer was “not if it's raining.”

Now we turn to the issue of whether collective conduct among competitors is anti-competitive. When this issue comes to counsel's attention before the conduct is undertaken, counsel may be able to shape the conduct to conform to the agencies' guides on collaboration among competitors and, particularly if the matter involves the health care industry, the 1996 *Statement of Antitrust Enforcement Policy on Health Care*. It may even be possible to obtain an agency view that the conduct as shaped will not attract enforcement action. The policy statements are written broadly enough to allow the agencies latitude in dealing with individual cases. As antitrust concerns hinge on the circumstances, the circumstances of such cases may persuade the agencies that anti-competitive effect is unlikely. The *National Cable* business review letter of October 2003⁶ allowed joint negotiation of purchases by competitors, which is normally antitrust-sensitive, but which may, as here, affect too few purchases to raise questions of monopsony. In *International Healthcare*,⁷ the Ninth Circuit upheld collaboration of doctors and others to propose changes to a health care contract. Some might say that such action by doctors' associations would come very close to the line in the sand drawn by the agencies. The *SPA* case,⁸ which is typical of others resolved last year, indicates that such medical associations should either confine themselves to acting as messengers—passing information to payors from doctors or *vice versa*—or provide some form of efficiency-enhancing integration. One form of such integration could be a combination of medical services that is less expensive to patients; there could be other examples of efficiency-enhancing joint ventures.

Two joint venture cases had a familiar ring. A court enjoined enforcement of the NCAA's rule that precluded Division I men's college basketball teams from playing in more than two certified tournaments every four years.⁹ The NCAA said the rule was justified because it prevented the athletes from missing class. Not too likely! But would that justification have been good if proved?

Another case found it unlawful for bank card systems—Visa and MasterCard—to prohibit their member banks from issuing cards on other systems, like Discover.¹⁰ The court noted that a member bank was free to join the Discover network if the member bank withdrew from the bank card networks, but no bank had chosen to do so. That indicated, according to the court, that the networks had market power. That issue will be explored by another panel, which will also consider last year's two other cases involving the bank card systems.

We turn now to single-firm action—as challenged under Section 2 of the Sherman Act—under the headings of monopolization and attempts to monopolize. There have recently been some substantial verdicts under Sec-

tion 2, but, as last year's cases indicate, there are also some daunting requirements of proof.

First, there must be, almost inevitably, proof of a relevant market, both product and geographic. See the *Golan* and *Morales* cases.¹¹

Second, where actual monopolization cannot be proven, and plaintiff relies on attempted monopolization, this in turn requires proof of a dangerous probability that monopoly power will be achieved.¹²

Third, proving monopoly power includes proving the monopolist's ability to control market price or its ability to exclude market participants. Although this ability may be inferred from possession of the predominant share of the relevant market,¹³ it is nevertheless a tricky proposition because the definitions of terms like "predominant" and "relevant" are also somewhat murky.

Fourth, the share (or the power) must be more than transitory. *Ticketmaster*¹⁴ indicates that even a high share is immaterial where many new opportunities for competition come up each year, thus making the market share transitory, and conveying no power.

When these requirements are satisfied, monopoly power may have been proven, but not monopolization. To take that further step, there must also be proof of exclusionary conduct. Again, the cases suggest some particulars.

First, the exclusionary conduct must be worse than trivial misbehavior such as advertising, which is presumed to be *de minimis* in some circuits.¹⁵

Second, the proof may not be limited to pricing below plaintiff's total cost. Some would hold that there can be no more effective means of driving newcomers out of the market than a pricing strategy that forces the newcomers to match an unremunerative price, whether or not that price is profitable to the incumbent. But the Supreme Court's decision in *Brooke*¹⁶ and last year's decision in *AMR*¹⁷ make it clear that an incumbent's low prices are immune from charges of illegality if they exceed an appropriate measure of the incumbent's cost. *AMR* used variable cost as such a measure. Legalities aside, it will be a rare case in which a newcomer into the market can long survive if for competitive reasons its pricing cannot exceed the variable cost of an established incumbent. The conclusion? If *AMR* is followed by other courts, the plaintiff in a predatory pricing case faces a substantial uphill fight.

Third, it now appears that refusals to deal will only rarely qualify as exclusionary conduct. Although it was on the basis of such conduct that the Supreme Court permitted a recovery in its 1985 *Aspen* case,¹⁸ the Court now appears to approach refusals to deal in a different light.

Now I am sure that most of you see where this discussion takes us. In *Verizon*, the Court was faced with an

antitrust claim based on a local telephone carrier's failure to discharge a statutory duty to make certain systems accessible to new entrants. Regulatory authorities had already proceeded against the carrier. The Court construed the regulatory statute to permit only antitrust claims based on traditional antitrust principles to be asserted in the circumstances, and ruled that the claim presented was to be distinguished from *Aspen*. In fact, the opinion states, in language that would catch every eye in this room, that *Aspen* was an exception to the general principle of lawfulness of refusals to deal and was "at or near the outer boundary of Section 2 liability." How can this characterization be expected to be treated by lower courts in monopolization cases? Is it not an indication that *Aspen* is to be relied upon only in limited circumstances? If so, given the Court's evident view that there may be only a thin line between anti-competitive monopolization and pro-competitive competition, what kind of conduct may be ruled as monopolistic? Failure to provide access to an essential facility? After the Supreme Court's description of *Aspen* as an exception to a permissive general rule, the same description may be applied to the essential facilities doctrine, and the lower courts may become even firmer in their reluctance to apply the doctrine.¹⁹ It is thus questionable whether this doctrine has much of a future as an indicator of a Section 2 violation.

The district court decision in *Dentsply*²⁰ is an example of what can go wrong in a government monopolization case. *Dentsply* was a leading supplier of artificial teeth, which it sold to dealers for resale. Its market share was between 67% and 80%. In order to maintain its market position, *Dentsply* threatened to terminate any of its dealers who handled competitive teeth. The government sued, invoking Section 2 of the Sherman Act, as well as Section 1 of the Sherman Act and Section 3 of the Clayton Act. The Section 2 charge collapsed when the court found that *Dentsply* had no power to control market prices or exclude competition, despite its substantial market share. The Section 1 and Section 3 counts were dismissed when the court found that depriving competitors of access to intermediaries did not substantially affect competitors. The court stated that competitors could sell directly to the dealers' customers. In addition, the court said that the competitors could offer the *Dentsply* dealers more favorable terms if desired, and that *Dentsply* had no means of preventing the dealers from accepting such terms.

If *Dentsply*, *AMR* and *Verizon* are followed, we may expect to see plaintiffs in monopoly cases facing a somewhat greater burden of proof than at present.

* * *

I will pass over some subjects that will be taken up by other panels, and will make brief comments on two subjects.

The issue in immunity cases is often not really a competitive one. It is more a matter of trying to determine what the Congress would want done in a situation involving the application of both a regulatory statute and the antitrust law. The right answer may be as suggested in *Verizon*: leave it to the regulators if their statute is more recent and more specific, and the regulators have done their job. In any case, it is clear that the right answer is not as given in the *Crist* case,²¹ which applies the baseball exemption to a case involving franchise relocation. The baseball exemption has no proper place in the law. The justification—*stare decisis*—seems specious when viewed alongside other decisions that have been overruled as no longer persuasive. Were *Schwinn* and *Albrecht* more important to correct because they had more general application? Perhaps, but that hardly justifies maintaining on the books a ruling based on a false premise. This immunity should be stricken from the books to avoid further embarrassment to our legal system.

One last topic is arbitration. The Seventh Circuit confirmed an award where arbitrators ruled on the validity of exclusivity provisions.²² In the past, questions of this nature were thought to be reserved for courts. In the current regime, which takes a more liberal view of arbitration, draftsmen of contracts need to think long and hard before delegating to arbitrators the power of decision on such important matters, particularly if the arbitrators are not under obligation to explain the basis for their decisions. Arbitrators given wide latitude to resolve all disputes arising under contracts could conceivably invalidate distribution systems or otherwise create substantial legal exposures. If broad arbitration clauses are meant only to provide inexpensive means of resolving minor disputes, they can at least be limited in scope, even if they prove to be no less costly than other means of dispute resolution.

MS. BOAST: Thank you, Bill, thank you Barbara and thank you, those of you who did get up this early. You are the antitrust equivalent of the NASA nerds who sit around waiting for the next red rock that our national pet, the Mars rover, will locate.

We don't have much time, and I know Barbara wanted to leave time for questions. I'm also confident that any meaningful delay this early in the day will set you back significantly. So I will speak relatively quickly, which is not a challenge for me. And I will try to truncate my remarks to some extent.

It seems to me that by any measure this has been a year of remarkable interest for antitrust lawyers. We have seen a year with decisions that have had the potential to have profound economic impact in the affected markets. We have the Second Circuit's affirmance of Judge Jones' decision in the *Visa/MasterCard* case and the *Wal-Mart* retailer case, with its settlement unlinking credit and debit cards. We have the Tenth Circuit's affirmance

of summary judgment in the *AMR* case, adhering to the *Brooke* group test for predation, and we have the Third Circuit en banc affirming the judgment against 3M in the loyalty rebate case, rejecting application of the *Brooke* group test to a species of nonprice predation. We have the Supreme Court granting cert in what I call two and a half cases; the half case the question being whether the Post Office is immune from antitrust liability, and already reaching a decision in one, that is the *Verizon* case. And the drug wars continue in appellate courts throughout the country.

But it has also been a year in which I think it has become more apparent than ever that we continue to search for workable standards in antitrust laws, those we can both articulate and apply in many areas. In the Section 2 area, as the *AMR* and *3M* decisions reflect, notwithstanding Bill's efforts to rationalize them, I think the law is kind of a mess. The agencies, at least the FTC, continue to press for narrowing immunities; we have a series of consents from the FTC directed at the state action doctrine. We also have the agency's scrutiny of various forms of self-regulation reflected in consents like the *National Academy of Arbitrators* and *South Carolina Dentists Board*. The courts seem to be heading the other direction.

There were two district court decisions dismissing claims on filed rate or *Keogh* doctrine grounds, one called *Ice Cream Liquidation* and the other called *Ultimax.com*. We have the Administrative Law Judge's decision dismissing the Commission Staff's complaint against Unocal on *Noerr-Pennington* grounds. And we had the Second Circuit's decision, which I happen to think is one of the more important decisions of the year, in *Friedman v. Salomon, Smith Barney*, holding that allowing the particular antitrust claims at issue there to proceed would conflict with the SEC's authority to regulate the relevant aspects of that industry. I think the decision is important because the basis for the immunity finding was not a conflict between actual application of the SEC's regulatory authority and the antitrust laws, but rather the fact that the agency had authority to regulate, even if it hadn't exercised it, to create immunity.

I should note in fairness, however, that the Second Circuit also said that state action immunity didn't apply to certain contested provisions of the master settlement agreement, the tobacco agreement. The scope of Sherman Act jurisdiction continues to be murky, although we hope for a little bit of clarity from the Supreme Court. And Section 1 law saw the introduction of two opinions from the FTC designed to clarify the relationship between the *per se* rule and the Rule of Reason, or more specifically, I think to restore a quick look approach. And it's to those decisions that I would like to turn and spend a couple of minutes.

Now in the interest of full disclosure, given the gestation period of an FTC case, I happen to have some inti-

mate familiarity with the facts underlying both of these decisions.

The *Three Tenors*, or *Polygram Holdings* as it is formally known, facts are simple. Three Tenors was a joint venture between two recording companies to produce the third album in this quite famous series. The joint venture agreement between Warner and Polygram specifically permitted the parties to exploit Three Tenors One and Three Tenors Two, the products related to those efforts. After the joint venture agreement was signed, the parties entered into what was called a “moratorium agreement,” in which they decided that they would refrain from discounting and advertising Three Tenors One and Two for a narrow window of time surrounding the launch of the third, new album.

Writing for the Commission, Chairman Muris used this as an occasion to articulate the Commission’s analytical approach in great detail. And there are at least two significant implications of his opinion. First of all, he straightforwardly, at least in the context of this kind of case, rejects the dichotomy between the per se rule and the Rule of Reason in favor of a “continuum approach.”

And secondly, as he has hinted since the beginning of his tenure, he moved away from the structural analysis, that is proof of a relevant market and use of market share presumptions, to an approach grounded in direct or empirical evidence.

His legal analysis begins with a lengthy exegesis of Section 1 laws reaching way back to the Supreme Court’s 1911 decision in *Standard Oil*. And even if you don’t agree with the result or the notion that there should be no erosion of the traditional dichotomy we have lived with, he makes a pretty persuasive case drawing on these precedents for the propositions, first, that not all trade restraints require the same degree of fact gathering and analysis to reach a conclusion, and, second, on the other hand, that summary condemnations, such as embodied in the per se rule, often mean that we lose sight of efficiencies that should be taken on board in the analysis.

Third, it is often possible to reach a preliminary determination simply by characterizing the restraint at issue. And fourth, the characterization should be borne of the question whether the practice is likely to restrict competition and reduce output.

Now, the *Three Tenors* opinion, I think, is clearly designed to restore the world to the analytical framework that existed prior to the Supreme Court’s *California Dental* decision, although the Chairman does manage to fit *California Dental* into his analysis. What results is a kind of back and forth of arguments and rationales before the kind of market evidence that we are used to is even required. The first step: The plaintiff must demonstrate that the restraint is “inherently suspect,” owing to its likely tendency to suppress competition. How do you

do this? The opinion advises you to look at past judicial experience, the law or current economic learning. If there is no other justification offered by the defendant, that inquiry ends the analysis.

In the face of that showing by plaintiff, the defendant can offer what he calls a legitimate justification. And again, the opinion explains in detail what this could consist of. This doesn’t require evidence. It simply requires offering a plausible reason why the restraint might be expected not to have the adverse effect the plaintiff asserts or reasons why it might be beneficial to consumers. So, as a defendant, you can take the suspect restraint back to neutral ground, or you could even do better and show that it is in fact pro-competitive. But again, we are just engaged in the dialogue at this point. There is no need for evidence, at least as Chairman Muris articulates it. It may be different in application.

The second thing for a defendant’s justification to be legitimate is that it has to be cognizable as a matter of law. It can’t be at odds with the goals of competition itself, and it has to be plausible. The defendant has to articulate a specific link between the challenged restraint and the justification.

After this what I call first tier exchange, the ball goes back to the plaintiff, who now must make a more detailed showing, the opinion says, of harm to competition. Now, this opinion specifically says—although again I think this could break down in application—that at this point you still don’t have to prove actual competitive effects if you’re the plaintiff. And you do have to wonder why this second tier analysis is in here at all. But Chairman Muris says this second level showing by the plaintiff can consist of a showing that effects are likely based on economic learning, or a showing that less restrictive routes to the defendant’s desired end were available. With that showing, the ball goes back to defendant for rebuttal, and maybe at some point we get to Rule of Reason proof.

Applying this set of steps to the *Three Tenors*, the Chairman draws on one of the very important, I think, principles from the Competitor Collaboration Guidelines of a few years ago. And that is that the moratorium agreement, this separate agreement, has to be analyzed independently of the joint venture itself. Ancillarity is not assumed; it has to be proven. And more specifically, he says, the joint venture context doesn’t alter the analytical framework. It is simply one more circumstance to be considered. With that sort of predicate, the Chairman says that the moratorium agreement is suspect based on law and empirical studies, and he discusses those. And then he says—and this is important in understanding how he thinks the defendants’ justification should operate—that their free rider argument doesn’t work here because the free rider argument applies to the promotion of Three Tenors Three. That is to say, it was free riding on Three Tenors Three that they were trying to protect;

whereas the subjects of the restraints were Three Tenors One and Two. Therefore, the justification was not cognizable, and that is the end of the inquiry. So Chairman Muris takes the analysis through the first tier, and he stops there.

We now fast forward a few months to the Commission's decision in *Schering-Plough*. We see, I think, some of the difficulties in trying to apply the *Three Tenors* test to another patent settlement case. *Schering-Plough* was an opinion written by Commissioner Leary in which the Commission addressed two settlement agreements between branded drug firms and generic efficiencies firms, the so-called Hatch-Waxman settlements.

I am going to presume, based on what I know this group has discussed in earlier years, that everybody has some basic understanding of the framework of these settlements and these cases. I'll simply note that in *Schering-Plough*, one difference was that in addition to payments from the branded firm to the generic firm in settlement of their patent dispute, the generic firm licensed products back to the branded firm. In his opinion, Commissioner Leary rejects the structural analysis in favor of this flexible inquiry. But there is a problem here because the restraint at issue, the settlement agreement, including the licensing back of products, was not one that the Commissioner felt comfortable labeling inherently suspect. And given the ALJ's disposition of the case, the record didn't really contain any analysis of the defendant's justifications.

Commissioner Leary notes that there was a way to characterize these agreements as a naked restraint—as a market allocation—but on the other hand, he notes that there is an argument that the agreements were ancillary to the overall settlement. But he doesn't really pursue either route. He concludes that the case occupies a "different space along the continuum" suggested in *Three Tenors*, and because it is not an inherently suspect restraint, a more detailed market inquiry is required—just not the structural approach employed by the ALJ. He says that even the infamous wrong-way payments, the money from the branded firm to the generic firm, don't make this restraint suspect. They just raise a red flag.

So Commissioner Leary's decision takes us to what I call the second tier analysis in *Three Tenors*, and he looks at judicial precedent—that's what *Three Tenors* requires—to find that the direct evidence of price effects is not necessary. And this is where I think the decision gets a little bit murky. He has difficulty identifying evidence of direct effects specific to this case because there hasn't been any generic entry. So he notes that there is ample evidence of the effects of generic entry in other products markets, and he notes a recognition by the parties in their own documents that this generic entry is a unique event. He labels this a *prima facie* case of actual effects. But there is no entry, so there are no effects in this partic-

ular drug market. He then shifts the burden to the defendants to prove that they have more than hypothetical benefits flowing from this arrangement.

The Commissioner's approach sounds more like the traditional Rule of Reason approach, even though he clearly means to be employing a *Three Tenors* analysis. I should note, of course, that all the decisions on which he relies to circumvent the structural approach of defining the market and to move to direct effects were written by courts that thought they were applying the Rule of Reason.

Observations on these decisions: I think there is some logical appeal in not confining horizontal restraints to dichotomized categories. But as I've suggested, I think that *Schering* demonstrates the difficulty of applying a highly specific series of analytic steps. If you take the *Three Tenors* approach and apply it too rigidly, you're going to stumble. So it may be that *Three Tenors* was perfect for that case but not that useful elsewhere.

Fundamentally, the cases probably really stand for different propositions. *Three Tenors* is a version of a quick look, truncated Rule of Reason case. *Schering-Plough* is really a direct effects case; that is to say, we are not going to stop to define relevant markets when we don't have to.

And while some may bemoan the weakening, not perhaps many in this room, of the *per se* rule that is reflected in Chairman Muris' approach in *Three Tenors*, the rule almost certainly appears to apply to hardcore cartel conduct. And I suspect if you look at his review of precedent over the years, you'd find that in instances where it wasn't totally obvious, the *per se* rule hasn't been used much in the last 20 years.

At the same time, if *Three Tenors* weakens the *per se* rule a bit, it also weakens the full-blown Rule of Reason approach. So we have winners and losers on both sides. At bottom, I think *Three Tenors* imports a kind of summary judgment standard. It really is asking the same kind of question a court asks on a summary judgment motion: Is this something about which reasonable minds could not differ? It remains to be seen if I'm right about whether this test will have any practical effect if it is imported to litigation outside the Commission.

Finally, I want to comment on a very, very recent decision that falls into the '04 category, but it will be so stale by the time you get to this meeting next year that it should be mentioned now. It reflects some of the problems the Commission had in *Schering-Plough*, stemming from the absence of evidence to establish what happened when entry had occurred. It is the merger case involving a company called Genzyme, which resulted in a 3-1-1 vote closing the investigation and a long, long statement by Chairman Muris with a dissent by Commissioner Thompson. I highly recommend it to you.

The case involved a merger between two companies that had drugs in the pipeline, not in the market, designed to treat a rare childhood disease. It is all about innovation effects, because neither drug was being manufactured for commercial sale. And if it is consistently followed in cases where innovation might be an issue, I actually think it will be one of the more important merger decisions of recent vintage.

The Chairman goes into great length explaining why there is insufficient empirical evidence of innovation effects in that case. And the dissent basically says it is a two-to-one merger to monopoly—surely some kind of presumption should be operating here. It is really quite fascinating. Chairman Muris, since he will be here this evening and, I take it, engaged in healthy dialogue with everyone, to me here is most precise in his articulation of what he said when he became Chairman and what he consistently said when asked about how he would conduct his administration. And that is that he will insist on “stubborn facts.” He did not find them in that case.

Thanks very much.

MS. ANTHONY: Any questions for Bill or Molly?

AUDIENCE MEMBER: I have a question. Molly, what significance do you attach to [Chairman Muris and Commissioner Thompson] concurring in the result in *Genzyme*, but not the opinion itself?

MS. BOAST: Let me tell you what I understand to have gone on. I understand that there was actually going to be a 4-0 vote in that case to close the investigation. And as the Commission’s effort to provide transparency has continued, statements started circulating and became longer and longer, and thoughts were woven into them that not everybody could agree with. I think the problem was, how are they going to prove this case? So analytically, I think the Commissioners who dissented or didn’t vote, but wrote what sound like dissents, disagreed with the thinking but not with the result.

MS. ANTHONY: Other questions?

AUDIENCE MEMBER: This is for Molly as well. The implication of what you said that Chairman Muris is doing is he is, in effect, sort of carving out his own doctrine, one would presume, with purpose, part at least, affecting courts. And the question is: Do you think that’s appropriate, or should the FTC really be following decisional law that the courts have laid down?

MS. BOAST: That’s a good question. I think that the Commission should not be taking positions that are fundamentally at odds with what the courts are doing. I do think it is open to the Commission, given the breadth of its jurisdiction and statutory mandate, to try to make new law in antitrust. It is an expert body precisely for that reason.

And that’s one of the reasons I commented on what I called the exegesis in the *Three Tenors* opinion. Because

what Chairman Muris has done (again, you may not agree with him) is to try to take all the cases and show—in part by their results, but in part by taking language from them—that what he’s doing here is not really new, that courts have been engaged in a quick look kind of approach for years. It is just they have been stuck with the labels. His underlying concern, I think, is that applying the per se label too often means that we lose sight of efficiencies.

MS. ANTHONY: We have time for one more, if there is one. Okay, if not, Molly and Bill, thank you so much.

Endnotes

1. We are referring to Section 1 of the Sherman Act, and not to Section 5 of the Federal Trade Commission Act, or various provisions of state unfair competition or other laws which may be triggered by unilateral action.
2. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).
3. *Masters v. Wilhelmina Model Agency, Inc.* 2003-1 CCH Trade Cases ¶ 73,938 (S.D.N.Y.).
4. *InterVest v. Bloomberg, L.P.*, 2003-2 CCH Trade Cases ¶ 74,117 (3d Cir.).
5. *Baker v. Jewel Food Stores, Inc.*, 2003-1 CCH Trade Cases ¶ 73,965 (Ill. Cir. Ct.); *Williamson Oil Co., Inc. v. Philip Morris USA*, 2003-2 CCH Trade Cases ¶ 74,158 (11th Cir.).
6. CCH Trade Reg. Rep. ¶ 44,103 (Letter 03-3).
7. *Int’l Healthcare Mgt. v. Hawaii Coalition for Health*, 2003-1 CCH Trade Cases ¶ 74,053.
8. *SPA Health Org.*, CCH Trade Reg. Rep. ¶ 15,419.
9. *Worldwide Basketball and Sports Tours, Inc. v. NCAA*, 2003-2 CCH Trade Cases ¶ 74,106 (S.D. Ohio).
10. *U.S. v. Visa U.S.A. Inc.*, 2003-2 CCH Trade Cases ¶ 74,151 (2d Cir.).
11. *Golan v. Pingel Enterprise*, 2002-2 CCH Trade Cases ¶ 73,857 (Fed. Cir.); *Morales-Villalobos v. Garcia Hotels*, 2003-1 CCH Trade Cases ¶ 73,924 (Fed. Cir.).
12. *Spectrum Sports v. McQuillan*, 506 U.S. 447 (1993), followed in *KIS, S.A. v. Foto Fantasy Inc.*, 2003-1 CCH Trade Cases ¶ 73,916 (N.D. Tex.).
13. *U.S. v. Grinnell*, 384 U.S. 563 (1966).
14. *Ticketmaster Corp. v. Tickets.com, Inc.*, 2003-1 CCH Trade Cases ¶ 74,013 (C.D. Cal.).
15. *American Council of Certified Pediatric Physicians v. American Board of Podiatric Surgery*, 2003-1 CCH Trade Cases ¶ 73,975 (6th Cir.).
16. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 289 (1993).
17. *U.S. v. AMR Corp.*, 2003-2 CCH Trade Cases ¶ 74,078 (10th Cir.).
18. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985).
19. *Pittsburg County v. City of McAlester*, 2003-2 CCH Trade Cases ¶ 74,183 (10th Cir.).
20. *U.S. v. Dentsply Int’l*, 2003-2 CCH Trade Cases ¶ 74,120 (D. Del.).
21. *Major League Baseball v. Crist*, 2003-1 CCH Trade Cases ¶ 74,039 (11th Cir.).
22. *Baxter Int’l v. Abbott Laboratories*, 2003-1 CCH Trade Cases ¶ 73,930 (7th Cir.).

Recent Developments Involving State Action Doctrine, *Noerr-Pennington*, and the Health Care Industry

MS. ANTHONY: We are ready to begin our second panel. We are a little bit behind, so I think you can go till about ten past the hour because this is such a great topic and such a great panel, and we don't want to eliminate any of it.

This panel is the panel that's going to try to align the scope of state action in *Noerr-Pennington* with antitrust objectives in dealing with the health care industry. No small task. The panel is headed by Ilene Gotts, and I'm going to introduce Ilene, and then she's going to introduce the rest of her panelists.

Ilene is a partner in the New York City law firm of Wachtell, Lipton, Rosen & Katz where she focuses on antitrust matters, particularly relating to mergers and acquisitions. I think there is hardly an international transaction where she has not been antitrust counsel. Some of them include Nestle and Dreyer's, the AT&T Corp., Comcast, AOL/Time Warner cases, Phillips Petroleum Company and Conoco, and the list is quite extensive.

Prior to her career with Wachtell, Ms. Gotts worked as a staff attorney in the Bureau of Competition of the Federal Trade Commission in conducting merger investigations. She was also part of the Bureau of Consumer Protection. She served as President of the Washington Council of Lawyers and was Chair of the Antitrust and Trade Regulation Section of the Federal Bar Association. Currently, she's a member of the American Law Institute and a member of the Executive Committee of our Antitrust Law Section. She has been enormously active in the antitrust section of the American Bar Association and currently serves on that council and is the chair of the task force on, what else, the Merger Review Process.

She has over 85 articles published on antitrust-related topics. She is a prolific author. She has her bachelor's degree magna cum laude from the University of Maryland, was a Phi Beta Kappa there, and her law degree cum laude is from Georgetown University.

We are very fortunate to have her today and thank her for putting this wonderful panel together. Thank you very much, Ilene.

MS. GOTTS: You might ask, why is a merger lawyer heading up a program on state action, *Noerr-Pennington*, and health care? And walking here today I thought about that. Twenty years ago I was a staff attorney at the Federal Trade Commission when there was a bureau director by the name of Tim Muris in the Bureau of Com-

petition, and one of the things he asked me to work on at that point was an FTC staff recommendation to sue U-Haul for its sham behavior in hurting a competitor, Jartram, in a bankruptcy proceeding, i.e., *Noerr-Pennington*.

And down the hall—this is twenty years ago—three doors down was another attorney who was working on an investigation regarding whether municipalities could be sued without running into state action doctrine problems for granting monopoly rights to the car rental operations in their airports. And in a building down the street, Toby was working in the health care shop, looking at whether the Blues were all too powerful and whether the hospital merger consolidation was going to result in higher prices. And across the street from there we had an office, where John is now working, that was looking at these issues from a policy shop perspective. You're going to hear from John what the policy section is doing today.

I understand they are studying the parameters of the *Noerr-Pennington* doctrine. So it is definitely "back to the future." It is twenty years later, we now have the FTC Bureau of Competition Director, Tim Muris, as the Chairman, and we see a lot of activities happening in all these areas.

We are going to have panelists—who are more active than I am today in *Noerr-Pennington*, state action and health care—give us a sense of this "back to the future."

Our first speaker is John Delacourt. John is currently the Chief Antitrust Counsel in the Federal Trade Commission's Office of Policy Planning. John has served as a member of both the Commission's State Action and the *Noerr-Pennington* Task Forces. He was also one of the principal drafters of the Commission's successful amicus brief in the *In re Bussiprone* matter. He's also worked on *Indiana Household Movers*. He is also very active in a variety of bar associations and has recently written some very good articles, which are included in your materials, that I would really commend to you for laying out the background of *Noerr-Pennington* and what the parameters would be.

With that, I'm going to turn it over to you, John.

MR. DELACOURT: Thank you for that introduction, Ilene. As you can see from this first slide and from Ilene's introduction, I'm going to be talking about the work of the FTC's State Action and *Noerr-Pennington* Task Forces.

Before I begin, however, I should give the usual disclaimer, that the views I express today are my own and

do not necessarily reflect the views of the Federal Trade Commission or any individual Commissioner. So with that out of the way I'll move right to the work of the State Action Task Force.

I think the appropriate place to begin is with the basics of state action itself. The state action doctrine was first articulated in *Parker v. Brown*, in which the Supreme Court held that the actions of the state itself are immune from antitrust enforcement. Essentially, *Parker* is grounded in principles of federalism and holds that, in passing the Sherman Act, Congress did not intend to limit the sovereign regulatory power of the states.

The *Parker* case, however, required some additional explanation as far as implementation was concerned, and that came in the Supreme Court's *Midcal* case, which basically deals with delegations of states' authority and sets forth rules to determine whether those delegations are being used appropriately or not.

Basically, as I've set forth here, the proponent of a state action defense must satisfy both parts of a two-part test. First, the proponent must demonstrate that the objectionable conduct is being pursued in furtherance of a "clearly articulated" state policy. Second, the proponent must demonstrate that the objectionable conduct is being "actively supervised" by the state.

At first blush, the *Parker* doctrine itself seems unproblematic. It functions, essentially, to shield an appropriate area of state regulatory conduct from antitrust enforcement. However, there have been numerous instances in which the doctrine has been interpreted overly broadly, in ways that do not promote the underlying objectives that the doctrine was intended to advance. These problematic interpretations have been the primary concern of the State Action Task Force. And I'll go over some of those interpretations right now.

One problem relates to the "clear articulation" requirement. Specifically it involves opinions by lower courts that have inferred an intent to displace competition from a grant of general corporate powers. States will often empower subsidiary regulatory authorities to enter into contracts, to make acquisitions and to enter into joint ventures. Although it is clear that the exercise of such powers in the private sector confers no special antitrust treatment, some courts have reached the opposite conclusion when the powers are granted through legislation. Thus some courts have concluded that exclusive contracts are the foreseeable result of a general powered contract, and still others have concluded that anti-competitive acquisitions are the foreseeable result of the general power to make acquisitions.

A second problem relates to the "active supervision" requirement. The problem here has not been overly expansive interpretations, but rather a simple lack of

judicial guidance as to what this requirement actually entails. The Supreme Court has set forth a number of verbal formulations. It has said, for example, that a state must engage in a "pointed reexamination" of the conduct. It has also stated that a state must exercise "ultimate control" or "independent judgment and control." However, without guidance on how to implement these various verbal formulations, in terms of actual state regulatory procedures, the active supervision requirement has continued to function as only a minimal limitation on the scope of state action immunity.

So what does the FTC propose to do about all of this, or at least the FTC's State Action Task Force? Well, recently, in September of 2003, the Task Force published a report, which sets forth not only its analysis of the law, but also specific recommendations for clarifying doctrine in a manner that will bring it more closely in line with its underlying objectives. I'd like to take a moment to go through a few of those recommendations now.

The first would be to clarify the proper interpretation of the "clear articulation" requirement. The goal here would be to ensure that a state truly intended to displace competition by authorizing the anti-competitive conduct at issue.

A second approach would be to elaborate clear standards for the "active supervision requirement." This will ensure that the requirement has teeth, and will prevent private entities from restraining competition, free from meaningful government oversight.

A third approach would be to clarify and rationalize the criteria for identifying quasi-governmental entities that should be subject to active supervision. Application of the active supervision requirement is appropriate, first, when an entity is functioning as a market participant and, second, in situations in which there is an appreciable risk that the anti-competitive conduct reflects the entity's own interests rather than the interests of the state.

So having described some of the recommendations that the Task Force has set forth, I would now like to describe a pair of recent Commission cases in which the Task Force, working with FTC complaint counsel, has attempted to implement these recommendations.

The first of these is the *Indiana Movers* case, which presented an opportunity to elaborate clear standards for the active supervision requirement. *Indiana Movers* involved an association representing approximately 70 household goods movers. One of the association's primary functions was to prepare and file tariffs on behalf of its members with the Indiana Department of Revenue.

According to the Commission's complaint, however, the association exceeded its role as a mere tariff filing

agent. The complaint alleges that the association actively engaged in the establishment of collective rates to be charged by competing movers.

The case was ultimately resolved by consent order, which eliminated the need to litigate the state action issue.

Nevertheless, the Commission took the opportunity to advance one of the proposals being considered by the State Action Task Force. In the analysis to aid public comment that accompanied the consent order, the Commission endeavored to elaborate clear standards for the active supervision requirement. Stated more specifically, the Commission set forth a list of factors that the FTC itself would consider in future cases to determine whether the active supervision requirement had been met. These factors include the following:

First, the development of an adequate factual record, including notice and opportunity to be heard.

Second, a written opinion on the merits.

And finally, a specific assessment, both qualitative and quantitative, of how private action comports with the substantive standards established by the state legislature.

This third factor requires a bit of additional explanation, as well as clarification of the fact that it does *not* constitute an attempt to impose federal standards on state decision making. Compliance with the state policy, whatever it may be, remains the benchmark. However, if the state policy expressly encompasses “protecting competition,” “protecting consumer welfare,” or other similar criteria, the Commission will look for something resembling antitrust review.

Now turning back to the health care field, I would like to say a few words about a more recent case, which is currently before the Commission on a motion to dismiss, *South Carolina State Board of Dentistry*. This case may present an opportunity to clarify the “clear articulation” requirement.

As in most jurisdictions, a dental hygienist working in the state of South Carolina must be supervised by a licensed dentist. In early 2000, however, the South Carolina legislature attempted to address the state’s growing crisis in oral health care services by amending the Dental Practices Act to reduce the level of required supervision. By reducing the level of supervision, the legislature sought to allow dental hygienists to operate more freely in certain institutional settings, such as nursing homes and public schools, in order to make certain basic oral health care services, such as teeth cleaning and sealant application, more widely available to underserved groups.

After the legislature had adjourned for the year, however, the Board of Dentistry immediately passed an emergency regulation that re-imposed the previous pre-amendment level of supervision. The Board’s regulation was not subtle, but rather used almost *the exact same language* that the legislature had just removed from the statute to define the required level of supervision. According to the staff’s complaint, the Board’s re-imposition of the pre-amendment level of supervision severely restricted the output of certain oral health care services—including cleanings, sealants, and fluoride treatments—to South Carolina school children.

Not surprisingly, the Dental Board responded to the Commission’s complaint with a motion to dismiss on state action grounds. This motion, which has now been fully briefed before the Commission, provided complaint counsel with the opportunity to say a few words about the clear articulation requirement.

First, complaint counsel argued that the Board’s general authority to regulate did not constitute a “clearly articulated” state policy. The Board argued that its mandate to regulate in the field of oral health care services was broad enough to cover any action, regardless of the competitive consequence. Complaint counsel, however, argued that the clear articulation test requires more: specifically, an expression of the state’s intention not merely to authorize conduct, but to displace competition in the matter at issue.

Second, complaint counsel argued that the legislature’s express removal of a statutory requirement constituted a clearly articulated policy *against* that requirement. According to complaint counsel, the Board’s position that the legislature’s express removal of a supervision requirement from the statute simply signaled an intention to leave the issue to the discretion of the Board did not give sufficient weight to the will of the legislature.

Finally, complaint counsel argued that the Board’s defiance of the legislature’s clearly articulated policy was not mere administrative error. A “good faith mistake” exception broad enough to encompass the Board’s egregious conduct, complaint counsel explained, would essentially swallow the clear articulation rule.

With these arguments as the principal framework, the state action issue was submitted to the Commission for resolution. Oral argument took place just a little over two weeks ago, and a decision from the Commission remains pending.

So those are the principal highlights of the work of the State Action Task Force. Now let me turn to the work of the *Noerr-Pennington* Task Force. Again, I think the appropriate place to start is with the basics of the *Noerr* doctrine.

Unlike the state action doctrine, which applies to delegations of government authority, the *Noerr-Pennington* doctrine shields a limited range of private conduct from antitrust scrutiny. More specifically, the *Noerr* case provides antitrust immunity for petitioning conduct. Such conduct essentially entails an effort to communicate with government for the purpose of urging and ultimately persuading the government to confer a privilege, or to take some official action. The *Noerr* case itself exempted from antitrust enforcement petitioning conduct directed towards a legislature. The companion case, *Pennington*, provided a similar exemption for conduct directed towards the executive branch.

More recently and perhaps more controversially, in *California Motor Transport* the Supreme Court held that the *Noerr-Pennington* doctrine also extends to petitioning conduct directed towards a court. This interpretation of the doctrine essentially encompasses the filing of lawsuits, which the Supreme Court has styled “judicial petitioning.”

Like the state action doctrine, the fundamental principles on which the *Noerr-Pennington* doctrine is based are sound. The doctrine is intended to prevent a range of *bona fide* political conduct—essentially First Amendment type conduct—from being chilled through antitrust enforcement. This aspect of the doctrine is not objectionable.

However, like the state action doctrine, in many instances the *Noerr* doctrine has been interpreted overly broadly. The principal problem here is that, while there are a number of limitations on the scope of the *Noerr* doctrine, the Task Force has determined that many of them have been interpreted extremely weakly.

Take, for example, the definition of “petitioning” itself—the first and most fundamental limitation on the scope of *Noerr*. Rather than functioning as a true limitation of the doctrine, this definition continues to grow.

The Fifth Circuit’s decision in *Coastal States Marketing* is instructive on this point. That case involved *threats* of litigation—not litigation itself, but merely threats, some of which were not even directed to specific parties. Plaintiff argued that, because the threats—as opposed to the litigation itself—were not directed to the government, they could not constitute “petitioning.” The Fifth Circuit, however, held otherwise. Other courts have retreated from the position that *Noerr*-protectible petitioning may entail no government involvement at all, but have yet to specify the precise level of involvement that is required.

A related problem is that while the definition of petitioning has continued to grow, the “sham” exception—the one universally recognized exception to the *Noerr* doctrine—has continued to shrink. The “sham” exception was first articulated in the *Noerr* case itself, and was

most recently revisited by the Supreme Court in *Professional Real Estate Investors*.

In that case, the Court set forth a two-part test for identifying “sham” petitioning. First, the proponent of *Noerr* immunity must demonstrate that the petitioning effort was “objectively baseless.” And second, if that first prong is satisfied, the proponent must then demonstrate that the petitioning effort reveals an intent to use the governmental *process*, as opposed to the outcome of the process, as an anti-competitive weapon. Due to some courts’ extremely restrictive interpretations, however, the “sham” analysis has increasingly been limited to a single step. For example, in *Porous Media*, the mere denial of defendant’s summary judgment motion was held to demonstrate the absence of “sham.”

Like the State Action Task Force, the *Noerr-Pennington* Task Force is also formulating recommendations regarding proposed clarifications of the doctrine. Its work is not as advanced as that of the State Action Task Force, as reflected by the fact that its final report is still a work in progress. However, the Task Force has managed to formulate a number of preliminary approaches, and I would like to take a moment to discuss a few of the most promising.

The first approach would be to apply a more restrictive view of the varieties of conduct that constitute protectible “petitioning.” This would involve looking to cases concerning tariff filings and private settlements, and applying the definition of “petitioning” developed in those cases to broader contexts.

A second approach would be to apply the *Walker Process* exception to *Noerr* beyond the patent prosecution context. In *Walker Process*, you will recall, the Supreme Court created a *Noerr* exception that was broader than the traditional “sham” exception. The decision was based in part on the fact that the Patent and Trademark Office has limited information-gathering capacity and, consequently, relies heavily on parties’ representations. Applying the *Walker Process* in other contexts simply reflects the fact that these limitations on information gathering capacity are *not* unique to the PTO.

Finally, the third approach would be to advocate full recognition of an independent material misrepresentation exception to *Noerr*, separate and distinct from the two-prong “sham” analysis set forth in *PRE*.

Having discussed a few of the preliminary approaches being considered by the Task Force, I will now move on to some actual cases. Specifically, I would like to take a moment to describe two recent Commission *Noerr* matters in which the Task Force, working closely with FTC complaint counsel, has attempted to move its preliminary approaches from theory to implementation.

The first is *In re Buspirone*, which Ilene briefly touched upon. This was not initially a Commission matter, but rather was a piece of private litigation in which the Commission elected to file an amicus brief to address a *Noerr* issue of first impression. The *Buspirone* case is notable primarily because it provided an excellent opportunity to argue in favor of a narrower definition of “petitioning” conduct.

The anti-competitive conduct alleged in the case arose in the context of the Hatch-Waxman Act, which provides a regulatory framework for the Food and Drug Administration approvals of generic drugs. The requirements of the Hatch-Waxman Act are numerous and complicated, so I will not describe them in detail. I will merely note that the Act requires an innovator drug company to list certain patents in the FDA’s Orange Book, and that the listed patents can then be used to trigger an automatic stay of FDA approval of generic equivalents of the innovator’s product. The automatic stay can have the effect of barring a competing product from the market for a period up to 30 months, so the potential competitive impact of an Orange Book listing is quite significant.

So why did the FTC decide to file an amicus brief here? Well, the specific issue the FTC wanted to comment on was whether the act of submitting an Orange Book filing to the FDA constituted “petitioning.” The defendant in the case, Bristol-Myers Squibb, argued that its communications with the FDA, including its Orange Book filings, were shielded from antitrust enforcement by *Noerr*. In response, the Commission filed its amicus brief, asserting that Orange Book filings are purely ministerial, and involved no exercise of governmental discretion whatsoever.

The district court agreed with the Commission’s argument, holding that Orange Book filings are analogous to tariff filings, and simply do not constitute “petitioning.” The court then advanced a second objective of the Task Force by holding that, even if Orange Book filings did constitute “petitioning,” application of the *Walker Process* exception would nevertheless preclude a *Noerr* in this case.

Notably, the *Buspirone* case, which addressed conduct before the FDA, is one of the first to extend the *Walker Process* exception beyond the PTO context.

I see that my time is running out, so I will wrap up with a few comments on the Commission’s *Unocal* case, which is still being litigated. This case is notable primarily because it presents an opportunity to further clarify and thereby strengthen the misrepresentation exception to *Noerr*.

Unocal is the most recent in a line of FTC cases addressing so-called “patent ambush” conduct. Specifically, the Commission has sought to impose antitrust lia-

bility for the non-disclosure, and subsequent enforcement of intellectual property rights in conjunction with industry-wide standard setting proceedings. The allegations in *Unocal* are thus very similar to the allegations in *Dell* and, more recently, *Rambus*. The principal difference is that while both *Dell* and *Rambus* involved private standard-setting organizations, the *Unocal* case involves the California Air Resources Board, or “CARB,” a government entity.

As expected, *Unocal* has asserted in response to the Commission’s complaint that its communications with CARB are shielded by *Noerr*. *Unocal*’s motion to dismiss on *Noerr* grounds was ultimately granted by the administrative law judge. However, the ALJ’s opinion was subsequently appealed to the full Commission. That matter has now been fully briefed and is awaiting oral argument.

In briefing the matter before the Commission, FTC complaint counsel made three principal arguments. First, *Unocal*’s conduct did not constitute “petitioning.” The core of this argument is that, in order for communications with government to constitute protectible “petitioning,” the governmental decision-maker must be aware that it is being asked to enact a restraint of trade.

Second, the staff asserted that, even if *Unocal*’s conduct did constitute “petitioning,” the misrepresentation exception applies. The key issue here is whether the CARB proceeding is regarded as quasi-legislative or quasi-adjudicatory. To date, the *Noerr* cases that have recognized a misrepresentation exception have generally held that the exception applies only in adjudicatory or quasi-adjudicatory proceedings.

Finally, and perhaps most controversially, the staff asserted that, because the *Noerr* doctrine is rooted in both the First Amendment and a statutory interpretation of the Sherman Act, it does not apply to antitrust enforcement actions brought under the Federal Trade Commission Act. This argument has its roots in a series of cases—the most recent being *B&K Construction*—in which courts have attempted to apply the *Noerr* doctrine outside the antitrust context. The courts in these cases have tended to reevaluate the scope of the *Noerr* exemption in light of the specific considerations underlying whatever non-Sherman Act statute happens to be at issue. In *B&K Construction* for example, the court tailored the scope of the *Noerr* exemption to reflect the specific considerations underlying the National Labor Relations Act.

In arguing for a narrower construction of *Noerr* in FTC Act cases, the staff pointed to two significant differences between the FTC Act and the Sherman Act. The first is that the FTC Act does not provide for private rights of action, and the second is that the FTC Act does not provide for treble damages. As a result, complaint

counsel argued that the risk of an FTC Act case chilling the exercise of First Amendment rights is significantly lower than the risk posed by an otherwise similar Sherman Act case.

Well, that concludes my prepared remarks, and hopefully provides you with at least a general sense of the objectives, and current status, of the work of the two Task Forces. There is certainly more that could be said, but I will resist the temptation, and instead will turn the floor over to my fellow panelists. I look forward to questions.

MS. GOTTS: Thank you, John, for setting the stage for us on what the FTC has been doing in the *Noerr* and state action area.

Our next speaker is Toby Singer.

Upon graduating from Georgetown, Toby became a staff attorney at the Federal Trade Commission in the health care shop and ultimately served as the Deputy Director for the Bureau of Competition. She joined Jones Day in 1989 and has been a partner there ever since.

What Toby is going to do is talk about federal and state antitrust challenges to hospital mergers, including the role of state action, and also spend some time talking about the FTC retrospective on hospital mergers and commenting on what John had to say.

MS. SINGER: I'd be glad to.

MS. GOTTS: Thank you.

MS. SINGER: Good morning. As Ilene said, I'm going to talk a little bit about both what John was addressing and some of the more direct health care issues that are happening right now at the agencies and in the courts. And there is a nice little intersection there, because one of the cases in the hospital merger arena involved the dismissal of an FTC challenge on state action grounds, so I'll spend a little bit of time talking about that.

As a prelude to what's going on right now, let me give a little history for those of you who are unfamiliar with the hospital merger story. Back in the 1980s, the early 1980s, the FTC and the Justice Department started bringing hospital merger cases, and those early challenges were, for the most part, successful. The government won cases in areas such as Rockford, Illinois; Augusta, Georgia; Chattanooga, Tennessee; and the one case the government lost in Roanoke, Virginia was put down as an aberration.

But things started to change. Starting in about the mid 90s and through the late 90s into early 2000, the government started losing cases. When I say the government, it was unanimous. It was the Federal Trade Commission, the Department of Justice and various state

attorneys general who unsuccessfully tried to get injunctions against proposed hospital mergers.

You had the Department of Justice losing a case here in New York in Long Island, as well as a case in Dubuque, Iowa. The FTC, accompanied by the Missouri Attorney General, lost a case in Poplar Bluff, Missouri and Joplin, Missouri. And finally, the last ditch effort to enjoin a hospital was brought by the Attorney General of California challenging a hospital merger in the Oakland-Berkeley area in the *Sutter Health* case.

The prevailing economic expert in that case was Ms. Guerin-Calvert here. The facts in all these cases were quite different, and you can categorize them in any number of ways. You have cases in very rural areas where it looked like they were the only two hospitals for miles around, and those would be the *Tenet* case in Poplar Bluff, and the *Mercy* case in Dubuque. You had some in medium-size towns, the *Butterworth* case in Grand Rapids brought by the FTC. And then of course cases in large urban areas, the *Long Island Jewish* case and the *Sutter* case in the East Bay of California, the San Francisco area.

In most, and I'd say the large majority of these cases, the defining factor, the reason that the government lost the case, was they were unsuccessful in proving relevant geographic market. And when you're thinking about large urban areas that maybe is not so surprising. There are a lot of hospital choices in the area, and it is maybe not an astonishing fact that in Oakland and Berkeley there are quite a number of hospital alternatives. But that also applied in very rural areas, such as Poplar Bluff, Missouri, where the nearest hospital was some fifty miles away. There is a lot of controversy, and I think Meg is going to get into that in her talk, about what is the right approach here, and how is it that "geographic" ought to be defined. What tools should be used in deciding what a hospital market really is?

But there are also a lot of other reasons why the government lost these cases. Product market was a reason in the *Long Island Jewish* case. The Justice Department alleged the two merging hospitals were the only two available "anchor hospitals" for managed care networks, and that by eliminating the rivalry between those two hospitals, managed care plans were forced to pay higher prices. The court rejected that argument.

In the Grand Rapids case, *Butterworth*, the FTC actually prevailed on most of their merits arguments, but the court found that the efficiencies arguments of the hospitals were very believable and were reinforced by the fact that these were not-for-profit organizations that were governed by boards made up of members of the community that the hospitals served. And those boards would make sure that the cost savings and efficiencies were

actually used for the benefit of the people of Grand Rapids, not for anti-competitive reasons.

In the *Sutter* case, not only was the geographic market a big issue, but the court found that the hospital to be acquired was a failing hospital, in one of the rare applications of the failing company defense.

Finally, last but not least, because I'll talk about it some more later, you have the *Lee Memorial* case, Hospital Board of Directors of Lee County, where the FTC sought an injunction against the acquisition of a hospital in Lee County, Florida. The case was dismissed on state action grounds.

Now, a lot of commentators and a lot of people in the government will say that the courts just don't like hospital merger cases, that they are going to find a way to dismiss these cases. That hospitals have a home court advantage because the government is going into federal court in the town where the hospitals are located, and the courts aren't willing to say that these community board members have made a decision that violates the antitrust laws. That's a view, however, that's not held by all. I refer you to the materials, which include a copy of my testimony at the FTC hearings that goes through some of the other reasons why the government tends to lose these cases, reasons that relate in most cases to an application of the relevant Merger Guidelines. I think the FTC in particular is thinking about what next to do in this area.

But before I get to that, let me focus for a moment on the *Lee Memorial* case, which is a very important case in the state action area, as well as in the hospital merger area. I should probably tell everybody up front that Jones Day litigated that case on behalf of Lee Memorial. I should also mention that Ilene here was representing the hospital that was acquired. So you have the full cast of characters here, if you include John as representing the FTC. We could probably spend hours arguing about this case, but we won't bore you all with that.

As John said, there are two aspects to the state action doctrine in most cases: The clear articulation requirement and active supervision. But in cases involving governmental or quasi-governmental entities, the courts, including the Supreme Court, have said that only the clear articulation requirement applies. That a municipality, for example, or some kind of government agency does not require the kind of active state supervision that is necessary when private parties seek antitrust immunity. So in the hospital state action cases, typically state action comes up because the hospital at issue is a governmental hospital of some kind. More often than not, it is a hospital authority, a hospital district, which is a municipal entity created by statute by the state legislature. And that's what the situation was in the *Lee Memorial* case.

And so the entire battleground there is clear articulation. Has the state legislature clearly articulated a policy to displace competition there? The clear articulation requirement in the context of governmental actors has moved into a concept called foreseeability; that comes out of the *Town of Hallie* case in the Supreme Court. And the question there, as John noted, is whether at the time the legislation was enacted, anti-competitive conduct by the entity was foreseeable from that grant of authority to engage in that activity. The FTC has been very frustrated with the propensity of the courts to find foreseeability in what they would characterize, and have characterized, as general grants of corporate powers, such as the authority to make acquisitions. Indeed, that was the kind of statute at issue in the *Lee Memorial* case. The FTC argued that just because you have a statute that says this particular hospital district can acquire other hospitals, that doesn't mean that the legislature foresaw that those acquisitions were necessarily going to be anti-competitive. And that's one way to look at this case.

But actually, the court went a lot further under the language than that and looked at the entire set of circumstances and what was surrounding that statute. In that case, the defendants showed that it was more than just a general go forth and be a corporation statute. For example, this hospital district was authorized to act only within that county. There had been subsequent amendments to the statute, making specific the authority to make new acquisitions. Putting all of that together, and noting that by definition any acquisition of a hospital authorized by the statute would be in the same market as that hospital district, the court found that under all those circumstances it was foreseeable that an acquisition of a neighboring hospital could be anti-competitive. That was based on not just a reading of that particular statute but other case law in the Eleventh Circuit. The district court dismissed on state action, and the Eleventh Circuit upheld the dismissal in what we would view as a well-reasoned opinion.

I think that it is very hard to argue with the general FTC position that a very general grant of authority by statute shouldn't be viewed as enough to trigger state action immunity. But I think at the same time, each statute needs to be examined very carefully to see whether it is just a general cookie-cutter kind of legislation or whether in that particular case there really is a decent foreseeability argument. I think the FTC's real quarrel is with the *Town of Hallie*'s decision that perhaps set the bar a little bit too low for finding state action immunity.

Now, looking at state action as applied in the hospital context in other situations, other than acquisitions, the cases are more of a mixed bag. Again, the district hospitals like Lee Memorial have typically prevailed in cases challenging, for example, granting staff privileges

or entering into exclusive contracts with physicians. And there the courts have held that a grant of authority to this hospital to, for example, engage in credentialing activities meant that it was foreseeable that they would exclude a physician or enter into an exclusive contract, and that was quite conceivably anti-competitive.

If you contrast that to the state action cases in the private context brought against private hospitals, you'll find that state action immunity has not been applied. But that's because the active supervision requirement has not been met. And in one of the important Supreme Court cases, *Patrick v. Burget*, involving credentialing, a staff privilege case where a physician sued under the antitrust laws for being precluded from a medical staff, even though the state statute said the hospital must do this kind of credentialing, the court held that without active state supervision, the state action defense did not apply.

In some cases private parties actually have successfully resisted state action arguments by municipal or district hospitals. The *Lancaster* case in California and the *Hammond* case in Louisiana are two examples. So it is not necessarily a foregone conclusion that a public hospital is going to get to act with antitrust immunity. And I think the FTC filed an amicus brief in the *Hammond* case and is actively working to find cases where they can perhaps educate the courts on different views.

Let me just take a minute here to talk about what is going on currently on the hospital merger front. After the string of losses taking out most of the 1990s, the government paused, and the FTC and the Justice Department haven't brought a hospital merger case in this decade. Even the states have finally given up, with the exception of cases perhaps that are more accurately characterized as Section 1 conspiracies. And so the FTC in particular is quite concerned about the inability to take action in what is a very important area of the economy. So they have decided to pause and take stock of where things went wrong and what's a better way to go about doing these cases.

One of the things they did is, they spent a lot of time at the hearings that they have had over the last year on various health care topics talking about various issues, including one session devoted entirely to what went wrong in these cases. And I think Meg is going to talk a little bit about the kinds of issues subsequently that came up and were discussed at length in the hearings. The FTC is preparing a report based on the hearings, that hopefully will come out with some very thoughtful comments on what the proper analysis should be, and what the right application of the evidence is. Because a lot of these things come down to basic evidentiary disputes.

But the other thing they are doing, that Ilene referred to, that is a very intriguing use of the FTC's authority, is

what they are calling the hospital merger retrospective. For those of you who think of the FTC as primarily an enforcement agency, it is easy to overlook the other aspect of their authority. And that is to engage in economic and other studies of various industries. A very important part of the FTC Act authorizes the FTC to gather information and conduct studies.

In fact, long ago in 1914, when the FTC was first created, that was a huge reason for their coming into being. So the FTC is combining that authority, the authority to collect information and do studies, with its investigative powers in conducting the hospital merger retrospective. What they are doing is reviewing already-consummated hospital mergers, two, three, four years after the fact, so that they can take a look at the market and see if they can figure out what actually happened. And the notion is that they will try to measure in some way whether or not there are anti-competitive effects, whether or not there are benefits from these transactions, were they market neutral, what actually went on. They have put teams of economists and lawyers together to look at very specific situations and specific markets.

There are two kinds of these reviews being conducted. The first kind—and some people actually question whether this is a really a good use of FTC resources—but the first category is to look at cases that have already been litigated and lost. So it's been publicly reported, for example, that the FTC is looking at the Tenet acquisition in Poplar Bluff, Missouri, which was litigated and lost. And they are looking at others that were litigated and lost. They are spending a lot of time issuing subpoenas and gathering data from the hospitals themselves, from hospital competitors, from health plans, trying to figure out what really happened after the merger, and trying to decide whether the predictions of the government when they tried to challenge the merger were what came true, or whether the defense was right about what actually occurred in the market.

The second category of cases are cases where there has been an acquisition or a merger and for one reason or another it was never investigated and never challenged prior to this point. And again, the FTC is investigating those using its subpoena authority, gathering information to try to measure price increases and other things in the market.

In the first category, cases that already had been brought, the plan is for the FTC to issue a report. We understand and they have said publicly that they plan to issue an economic report using an analysis that has been used before by the FTC Bureau of Economics in studying other past hospital mergers, based on publicly available data. There is a report, for example, commenting on a merger in Santa Cruz, California that was done by two FTC economists. And using that same theoretical frame-

work, but this time with actual data from the merging hospitals and others, they plan to do an analysis and issue a report saying prices went up, prices didn't go up, you know, whatever their conclusions are.

Perhaps the more interesting part of it, though, is those cases that had not been investigated before. And in those cases they are conducting real investigations and using their law enforcement authority. And they have said that in the appropriate case they will challenge an already-consummated hospital merger, bring an FTC administrative case and seek divestiture to remedy the anti-competitive effects that they have found. What they have said is they are looking for cases where there will still be a remedy available, where there is a hospital to divest, where there is good strong evidence of price increases or other anti-competitive effects, and where the efficiencies that were projected or claimed by the hospitals really have not been realized.

We keep hearing that they are about to issue a complaint, but it hasn't happened yet. And those of us who defend these cases are wondering whether they are running into the same kind of difficulties, even after the fact, that they ran into when trying to challenge a merger up front.

The only thing that's public that the Commission actually has done in the hospital merger area, since they lost their last case, is to write a letter. There was a proposed acquisition in Slidell, Louisiana in a very unusual context. It was an acquisition of a publicly owned hospital, and the acquisition required (a) the approval of the Attorney General and (b) a referendum by the citizens of Slidell, Louisiana. That's actually not an uncommon setup for a public hospital. And the FTC conducted an investigation of the proposed acquisition and concluded that it was likely to have anti-competitive effects. So the FTC wrote a letter to the Attorney General of Louisiana, that it then publicly released, recommending that the Attorney General not approve the transaction. That recommendation was based on the FTC's theories on how hospital mergers ought to be looked at—these theories closely resembled the ones used in the prior cases—and the FTC concluded that the acquisition should not be approved. We don't know what the Attorney General would have done, because the referendum was held, and the population voted against this transaction. Hard to know whether the FTC letter had something to do with that. But hard to believe that it had no impact at all.

That concludes my remarks, and I'll be happy to take questions later.

MS. GOTTS: Well, you've heard from two lawyers, and just like in any antitrust investigation, you also want to involve some economists. We are going to shift over to hearing from Meg Guerin-Calvert. Meg is the President and Managing Director of Competition Policy Associates

Inc., which is a recently formed economic consulting group.

Meg's practice includes the health care as well as financial and network industries. She was formerly the Assistant Chief of the Economic Regulatory Section of the Antitrust Division at the Department of Justice, so we are going to get some diversity by hearing from Justice, and she's going to focus a little bit on the economist's viewpoint on physician issues, as well as perhaps even broader health care.

I turn it over to you, Meg.

MS. GUERIN-CALVERT: Thanks, Ilene.

I have to be mindful of the fact that one of my partners in this new venture, Janusz Ordovery, is sitting in the back. So I'll take advance blame for any errors that I make, they're just mine. They do not accrue to anybody else.

What I would like to do is, following up on what you've heard already, to give a very, very quick perspective of what has gone on in the industry in antitrust, particularly in the context of all of the panels that went on at the FTC hearings. Because I think they were a very good opportunity sponsored by the Department and the FTC to kind of focus us on where is the empirical evidence, where are we on the analytics. There are some really important areas of consensus which I think were key that they came out, and still some very important differences—I think largely, as Toby referred to, in terms of applications of common principles rather than differences in principles. And so what I would like to do is kind of focus on some of the information with respect to the empirical evidence on pricing and reimbursement, as well as cost trends and contracting practices.

There have been a number of developments that have really changed the landscape quite a bit in the last couple of years, and that actually raises some interesting issues, I think, both for the retrospectives as well as for analysis of hospital and physician issues. I would like to talk briefly about hospital merger analysis, because that is, I think, where we have come the farthest. But a very key area of inquiry these days, both by the federal agencies, state agencies and even private antitrust, are issues related to physician practices, physician consolidation, physician hospital organizations, and particularly in a whole new area where there is much increased focus on ideas of how to improve quality, how to have the necessary amount of integration, and other nonprice factors.

In terms of recent trends, this slide here is really a snapshot that says if you look at the world between say 1994-95 and today and contrast it with the prior decade from 1985-95 you will see some vital shifts that affect the dynamics of competitive analysis, that have affected pricing, and ability to manage costs.

One that we are all personally probably very familiar with is the idea that consumers in general have had a backlash to HMOs. Where largely HMOs had very small networks of providers, either physicians or hospitals, limited choice and, in exchange for going through the mechanism of a gatekeeper physician, they promised relatively modest premiums. After the experience of that rapid penetration across the country, more and more consumers said on average, I'm willing to pay somewhat more; I want a whole lot more choice. So managed care plans shifted.

If you look at the enrollment trends, where we used to have the majority of those insured under managed care in HMOs, we now have the majority in PPOs. What this means is that it is happening at the same time with the second category. The last five years have been a period of massive increases in the underlying input costs. Labor is one of them. It has affected a lot of metropolitan areas in particular, but the key trends are pharmaceuticals, technology and also increased usage, in part due to the trend toward PPO and less managed care, but also in terms of aging population. What we had with it is the revenue or the reimbursement side of the hospital has to largely cover all of those items.

So you see, no matter which community you look at, no matter which data set you look at, since roughly around 1998-99, very, very substantial increases in the prices that are being charged to commercially insured companies—and again that's not surprising, because largely Medicare and Medicaid reimbursement is dictated by the government. So the only area in which you can have some sort of increase is in the commercial side. And that has raised a number of issues and a number of concerns.

Then, lastly, we have a very complex change in contracting practices. Much of it is evolution, but some of it is also response. As hospitals and payors in response to consumer demand move from smaller exclusive networks to larger networks, in the New York metropolitan area virtually every hospital of any consequence is going to be in the PPO network of virtually every major plan. Once you do that as a payor, you no longer have the ability to threaten to keep somebody out of the network in order to discipline their pricing. You have to do what many payors have been doing in many marketplaces, which is steering enough patients—not all of them—but steering enough patients to lower-cost hospitals or threatening to do so to discipline pricing.

Also just two other side notes. There is much less in the way of full-risk contracting, where hospitals and physicians take on almost all of the roles of payors. Largely, a lot of HMOs found they had difficulty doing all those tasks and have gone back to more traditional contracting, and we also have some tiering going on.

I think the key thing is, and let me be abbreviated here, what has come out in the hearings in terms of one of the core parts, as Toby referenced, in hospital merger analysis is that there are some common concepts that everyone is in agreement with. There is a general acceptance that the principles in the Merger Guidelines work in the area, whether it is hospitals or physicians. The use of the hypothetical monopolist paradigm makes sense for a market definition. It works in this area. Application of the principles of critical loss or critical elasticity works in this area, the concept of critical loss being how much diversion of patients to other hospitals is needed to discipline a firm or a group of firms from profitably being able to raise price. It is something that is measurable in the health care area, because we have good cost data, and we have good information on which to do the estimation.

Two key issues, though, that continue to surface and were in each and every one of the hearings as key issues are in the application. How should one use the patient origin data, and how should one really go about testing for the sufficiency of diversion? The patient origin data really does come down to market definition. Oftentimes when one is looking at a hospital merger case, say in the instance of Long Island, if you're looking at LIJ and North Shore, and in full disclosure I worked for the parties in that case, what one starts with—and economists on both sides do this—is you look at each of those hospitals and you pose the questions: Where are they getting their patients from? Who is coming to them? Which physicians are referring patients to them? And fortunately, in the hospital context, also in the physician context, you have relatively good data that tells you, by zip code, huge samples where people have come from. Then that gives you at least a starting point analytically. It is the equivalent of a big transactions database of the choices people have actually made. You can look at residents of those same zip codes, and pose the question: Where else are those people tending to go to now?

One of the things I found very interesting in the *LIJ/North Shore* case is that in general, and somewhat surprisingly to me, there were more people from the general area around LIJ and North Shore who were going to Manhattan hospitals, not just for cardiac care but also for primary and secondary services, such as delivery of babies, for general surgery, for elective tonsillectomies, for non-emergent services. And that in general laid a factual basis for the market certainly being broader than the two-mile area around the hospitals that the government had alleged, but also potentially broader than Nassau and Queens. It was in that case sufficient to only get to Nassau and Queens to have enough other hospitals in the market to discipline competition. But that again is the factual inquiry.

One thing that I want to mention is there is a lot of blending of the concept of patient origin data. And the Elzinga-Hogarty analysis is a mechanism or methodology that Professor Ken Elzinga and his colleague came up with in the context, primarily, of flow. Again, just trying to use flow to identify the boundaries of a geographic market. There is really a very broad consensus among economists now that that application really does not work well in the hospital context. At best it is a methodology; it is a starting point. But many people think that that criticism means that one is actually tending to want to throw out patient origin data.

So I think one of the things I got from the hearings was a strong sense of the number two point, which is we really ought to be working with these data. But the number three point, we shouldn't narrow ourselves or get lost in a single methodology. We should use it much more so it is consistent with the principles of the Merger Guidelines.

And again, as I mentioned, the key issue for competitive effects analysis in the hospital case is really how to ascertain, how to quantify the magnitude of patients that need to shift and then how to demonstrate that it could work.

Just to follow-up very quickly on Toby's point, one of the things, if you look back at the whole history of the court cases, one of the things that has made a difference between the views of the parties on both sides is the evidence with respect to whether or not managed care plans currently were successful in moving patients and whether they had the mechanisms, as contrasted with statements saying we don't like to do this. And I think that will be an interesting part again in future cases as to whether or not (a) the payors have the mechanisms and (b) they have exercised them in the marketplace.

Rather than spending more time on the competitive effects analysis in hospitals, let me give you a quick focus, because I think this is the area where we have seen the most recent activity by the FTC, and to a lesser extent by the Department of Justice, and where I think we are going to see a lot more.

The hearings focused a lot on defining market power in the physician context. And again, it is a matter in part of identifying the relevant geographic area, but particularly trying to collect data and information on who the providers are is more challenging, because the data are not quite so accessible. But the hearings and the cases really have tended to focus on issues as to, on the one hand, where physicians were engaged from practices either in the physician group or in conjunction with hospitals where there was activity regarded as naked price fixing. Really the whole purpose of the organization, it was argued, was simply to have common contracting as opposed to creation of true integration, improvements of

quality or development of new products. And I think it is in that area where there is going to be, I suspect, the most tension and the most interest going forward. Because what we have seen in the marketplace is that, in general, payors have been searching for mechanisms to try, in essence, to compensate physicians for increased quality of care, to have increased information available on improved outcomes. But where we have seen relatively little development from the physician side or the physician hospital organization side is on trying to come up with new integrated products or quality enhancement products. And I think that's probably what we'll see in the next round in terms of business reviews and complex issues.

Involved in all of those I think will, of course, be the issue of analysis of market power. The more the network is a nonexclusive one, the more it is that it has a modest share in a given relevant market, the less likely it is to raise issues. So I guess where I put it in context, before turning it over to the next panelist, is I think we are at a point where there is a very good consensus on what the analytical paradigm is. If everyone goes back and looks at those hearing transcripts, I think that is that consensus.

There is also a firm view that there is an enormous amount of new empirical data out there as to what has happened in this marketplace that explains price trends that are due to factors other than anti-competitive effects that allow us to isolate it. But I think the key difficult area is going to be if people continue to apply the paradigms to evidence in fundamentally different ways, or that do not capture these new developments, I think we still may see some differences in outcomes. However, to the extent they are applied in the same way, it may be that we will have a much more robust ability in the future to look at the distinction between those things that improve efficiency and are competitively either neutral or pro-competitive from those either physician acquisitions or consolidations or hospital mergers and consolidations that are anti-competitive.

MS. GOTTS: Thank you, Meg.

Our final speaker for this session is Connie Robinson. And Connie, I think, this is the first time I get to introduce you as a member of the private bar.

Connie left the Justice Department after 27 years. In her last position she was the director of operations and the Director of Civil Enforcement for the Antitrust Division, and in the fall joined as a partner at Kilpatrick Stockton in Washington, D.C.

Connie is going to wrap us up by talking about pharmacy cases, physician price-fixing, *California Dentists* and anything else you can do in 18 minutes or less.

MS. ROBINSON: The good news is I'm the last speaker. The bad news is people have already heard some of the cases that I'm going to be talking about. But I'll give you a different lens to look at them.

Toby mentioned how important health care is to our economy at large. It is a significant percentage of our gross national product. And Meg mentioned the concern about rising health care costs which American consumers look at as one of the primary issues they have on their minds. And I think these two characteristics are the reason why the antitrust enforcement agencies give close scrutiny to what is happening in the health care arena.

I want to talk about just three areas and tell you briefly about what's been happening in the civil conduct areas at the agencies in the health care arena. The first is pharmaceutical patent disputes. I think they are very interesting cases for a variety of reasons. Then I will discuss the physician price-fixing cases and a few other cases involving anti-competitive agreements.

Pharmaceuticals. The government has brought a number of cases in this area. Three of them you can characterize as coercive behavior between a generic drug manufacturer and the pioneer drug manufacturer, and the other two really rest on unilateral conduct.

First, I need to give you some regulatory background. Under the Food, Drug and Cosmetic Act, an applicant who wants to market a new drug must apply to the FDA for approval by filing a new drug application and providing a report that the drug is safe and effective for its intended use. But under another statute, the Hatch-Waxman Act, which was really enacted to try to speed up the development of generic drugs, there is a streamlined procedure. And so a generic who wants to file an application can rely on the safety and effectiveness tests conducted by the pioneer, so long as the generic drug can be shown as to be the same as or equivalent to the approved drug.

Now, the generic applicant must certify a number of things. The one that really becomes the most important in this set of cases is what is called the Paragraph IV certification. The generic must certify that a patent is invalid or will not be infringed. So one of the really interesting issues about these sets of cases is the interplay that they have between the intellectual property regime and the competition regime. And there is also another tension here, and that's the tension between encouraging settlements and the competition laws, all of which makes this a challenging situation for an antitrust lawyer to consider.

Now, if you make this Paragraph IV certification, you then have to, if you're the generic, provide notice to the patent holder. The patent holder then has 45 days in

which to file a patent infringement case. If that patent infringement case is filed, there is an automatic stay of about 30 months, and the FDA may not start the approval process until that period concludes. There is also one other little wrinkle in this, and that is the first generic to apply for the application gets, once it begins to market, a 180-day exclusivity period. Again, this period will be important in these cases.

Now, let me just tell you a little bit about the *Abbott/Geneva* case. This is characteristic of the three cases that we have seen. In this case Geneva filed for FDA approval of a generic version of Terazosin, in tablet form. Two years later, it filed a generic version for the capsule form. It made those Paragraph IV certifications with the FDA, and Abbott sued Geneva within the right time period for the tablet form, but for some reason did not do anything about the capsule form. On the day that FDA approval was received by Geneva for the tablet form, it basically went to Abbott and it said, unless you pay me, I'm going to put my generic on the market. The two entered negotiations; two days later they agreed that Geneva would not enter until the earlier of a final resolution of the patent infringement case or the entry of another generic.

There was a fascinating set of payments here, called reverse payments because they seem counter-intuitive. Instead of the generic paying the manufacturer that originally made the drug, the payments go in the opposite direction. Abbott agreed to pay Geneva \$4.5 million per month until there was a district court decision. And assuming Geneva won that decision, Abbott would continue to pay \$4.5 million per month into an escrow account. Abbott would be entitled to the funds in escrow if it ultimately prevailed. But it would never recover the funds that Geneva had obtained before the district court opinion.

The facts of the case showed that \$4.5 million was in fact a great deal more than what Geneva expected to make if it was coming into the market—between \$1 and 1.5 million a month. So there is a heavy premium here. It is obviously very worthwhile to continue to market a drug without competition. Indeed, some of the studies have shown there is about a 45% decrease in your profits the first year that a generic enters.

So this was a potential competition case where Geneva effectively told the FDA it was going to enter the market. It was confident it was going to prevail in the patent infringement litigation, and it was preparing to launch distribution of the capsules. It told Abbott that. The FTC alleged that entry was harmed because Geneva was not going to enter as soon as planned and because the 180-day exclusivity period precluded other generics from coming in during that period of time.

But this case raises very complicated issues. How do you distinguish between anti-competitive settlements and those that are competitively benign? And how does an agency know whether a patent is valid or not?

The consent decree in *Abbott/Geneva* is also interesting in the way it handled some of the tough issues. First, it prohibits agreements that restrict (1) the generic company's ability to waive its Hatch-Waxman 180-day rights and (2) the generic's ability to enter the market with a non-infringing drug. The first prohibition concerns agreements to delay generic entry. But the settlement treated more delicately the issue of payments under a settlement agreement. In recognition of the fact that settling a case may be benign or even pro-competitive the settlement requires that future settlements have to be approved by a court, with some opportunity for the Commission to be able to express its views to the court.

There has been a lot of private litigation following from these cases, and I wanted to note that for you. In one of the cases, the *Cardizem* case, the court held these reverse payments were per se unlawful. The other cases apply the Rule of Reason analysis. And the last case on the slide, *Asahi*, is a Judge Posner decision where the Judge says the case is not about reverse settlements, but he then explains his belief that reverse settlements may be pro-competitive. So he is entering the debate by expressing his views on this developing issue.

Now, the *Schering-Plough* case is one that you've already heard the facts about. It is similar in facts to *Abbott/Geneva*. There was a payment, but there were also some licenses received in return and an issue about whether or not the consideration paid, very high consideration, was justified by these licenses. But the decision has some very important parts.

First, Commissioner Leary finds that the IP rights here are not relevant to the antitrust analysis. The ALJ, on the other hand, considered the case to involve a patent monopoly. In fact, the evidence showed the generics were entering the market before the patent had expired. And so the ALJ held that the FTC needed to prove whether there were valid patents or whether they had been infringed. Commissioner Leary tells us that you really don't have to get to that issue. And I think what has to be underlying his analysis is an assumption that "but for" the settlement the firms entered into, they would have reached some other kind of settlement that would still have brought somebody into the market before the patent had expired. Commissioner Leary also found that it was unnecessary to define a relevant market when there is proof of anti-competitive effect. And you've heard plenty about that this morning.

The other two cases are the Orange Book cases, and these challenge unilateral conduct by manufacturers of drugs. When you read them, the facts suggest fraud.

Basically, the FTC believed that these companies misused the Hatch-Waxman regulations to mislead the FDA and the Patent Trademark Office. The companies entered patents on the Orange Book that should not have been on the Orange Book, and then they went forward and litigated—in baseless litigation—to keep the generic out of market, preventing entry.

You've already heard from John about the *Noerr-Pennington* arguments. And in this case I believe one of the exceptions that the FTC is relying on is the sham exception.

The FTC sought injunctive relief in these cases to prevent certain behavior with respect to Orange Book listings and to prevent the kind of litigation that was engaged in here.

The second category of cases I wanted to touch on are physician agreements on price. I think the list shows it all. In the last year there have been a dozen cases brought by the agencies to go after physician price-fixing. The first case on the list, the *Mountain Health Care* case, was one I happened to work on when I was in the agency, and because I think it is characteristic of the kinds of cases these are, I'll describe it briefly.

Essentially, you had the physicians and physician groups in the state joining together, coming together with a uniform payment schedule and refusing to deal except on the basis of that uniform schedule. One thing you see in these cases are usually large groups of physicians. For example, in *Yakima*, 90% of the doctors in the areas doing general surgery were involved. In the *Physicians Network* case, almost 70% of the orthopedic surgeons were involved. So you're seeing collective action by large groups of physicians, and the agency is viewing that as per se price-fixing. The typical relief has been injunctive relief. In ten out of the twelve cases, you see provisions such as: thou shalt not do this behavior anymore. But in two of the cases the agencies sought dissolution of the physician association.

That brings me to the last two types of cases, the other category. John has already told you about the *South Carolina State Board of Dentistry* case, and my take on that case simply is that a legislative entity had a rule that prevented a hygienist from caring for a child unless a dentist also saw the child. The legislature struck that rule, but the Board reinstated it and expanded it. FTC views this conduct as really bad news for all those school children who need preventative health care.

And then, finally, *Dentsply*. You heard a little bit about the decision this morning. Again, the confession: I worked on this case when I was at Justice, so I have a particular point of view. It seems to me that in this exclusive dealing case, the decision of the court was somewhat schizophrenic as the judge found something for

everybody. The court held Dentsply had high, exceptionally stable market shares for fifteen years. I'm talking about 75-80% market shares. The court also found that Dentsply had exclusionary intent, and adopted its exclusionary rules with exclusionary intent. Indeed, the judge referred to Dentsply as having anti-competitive exclusionary intent. Also, Dentsply's business justifications, according to the court, were pretextual. They had nothing to do with arguments advanced at trial. What motivated Dentsply was the exclusion of competitors.

The exclusionary criterion are twofold in this case. One, if a distributor wanted to carry Dentsply teeth, it could only carry Dentsply's products. And once a distributor was carrying Dentsply teeth, if it tried to carry somebody else's products, it lost Dentsply's teeth. The court also found that there were no efficiencies to the deal.

Now, having found all these things, the court went on to say there were viable distribution alternatives for other manufacturers. They could go directly to the dentists. I think there were thousands and thousands of them. The court also found that the rivals—there are two other major rivals with market shares of 5% and 3% consistently over 15 years—were not very aggressive or not very good marketers.

Well, the DOJ is appealing this case. It is basically arguing that these provisions have been in effect for 15 years. *Dentsply* worked hard to keep them in effect; and as the court said, these provisions were put in effect to

be anti-competitive. Why would Dentsply try so hard to keep them in effect to prevent its dealers from carrying other firms' products if they did not have some purpose? And if the rivals were so inept, why would Dentsply care if others sold their goods through the distributors? Basically, the DOJ says that it believes the court didn't look at the economic reasons operating here. Nor did it look at the evidence that there was a price umbrella and Dentsply was the price leader. It found only that Dentsply priced between two other players. But, in fact, the evidence was strong on price leadership. In that it ignored the law of monopoly maintenance. So it remains to be seen what will happen.

In summary, what you see is the agencies working hard for consumers, trying to lower the prices of those important inputs Meg talked about, making sure prices for physicians are maintained or not raised, trying to help both our children and the rest of us so we can get good health care or artificial teeth at good prices. Thank you very much.

MS. GOTT: Connie, thank you for being a perfect panelist by making my job easy and ending exactly on time. Do we have time for, like, two questions?

MS. ANTHONY: Sure.

MS. GOTT: Does anyone have any questions, or do you all need a coffee break very desperately? Well, I think everyone looks like they need a coffee break. I would like to thank the panelists for all their hard work. And enjoy your coffee.

Antitrust Injury Panel

MS. ANTHONY: We are ready for our final panel of the morning.

I'm Barbara Anthony, the Chair of the Section and the Chair of this program today. For those of you who may have come in late, let me welcome you to our program, and again mention that we have two great panels yet to go.

Our next panel features a subject that all antitrust lawyers can agree to disagree on, and that is antitrust injury. We never seem to tire of debating the subject and challenging each other's views on the subject and coming up with new and novel ways to define, measure and otherwise discuss it.

Heading up this panel, I want to say thank you to David Hayes for putting together a very, very distinguished group of panelists. Mr. Hayes is of counsel to the law firm of Bond, Schoeneck & King, and he is in their Syracuse, New York office.

He advises clients in matters concerning business law, including antitrust, corporate governance, finance, insurance, securities and strategic planning. He is a frequent speaker and panelist on issues such as Sarbanes-Oxley, best practices for corporate governance and general commercial litigation trial strategies. David is also an Adjunct Professor of Law at the Syracuse University College of Law where he teaches the Antitrust course. Mr. Hayes is a graduate of Syracuse University and the University of Virginia Law School.

Thank you again, David, for organizing this panel, and I will turn this over to you.

MR. HAYES: Good morning. Thank you, Barbara.

We are going to discuss this morning the elusive doctrine of antitrust injury and hopefully illuminate for you what antitrust injury is all about.

To set the context of antitrust injury, I want to share with you edited excerpts from the oral argument in the *Verizon v. Trinko* case which we heard about this morning. That case was decided earlier this month by the United States Supreme Court. Oral argument was held October 14. The Solicitor General appeared on behalf of the United States as amicus supporting the defendant Verizon. As the Solicitor General, Ted Olson, began his argument Justice Stevens posed the following question:

Mr. Solicitor General, before you get into your argument, do you have a position on the standing issue?

Mr. Olson: We did not brief and we did not take a position in our briefing on the

standing issue. Our reason for doing that, Justice Stevens, is that we believe in order to ascertain antitrust standing, one has to connect the injury, the alleged injury, to an antitrust violation. We feel the question of whether or not there is an antitrust violation in this case comes before the determination of the antitrust injury. And therefore, the United States did not brief that question.

Justice Scalia: Excuse me? We certainly don't do this for standing normally. We say the question of whether or not there is an injury comes before the question of whether there has been a violation. That is what standing is all about. And you say the government has just concluded that both questions are of equal priority, and that's not just the way we usually work.

Mr. Olson: We felt, Justice Scalia, not in the context of Article III standing, but in the context of prudential standing, in the context of antitrust standing which relates specifically to something this court has called antitrust injury, which ties into a particular violation, and in order to determine that here, we felt the court would have to first answer the question whether there is an antitrust [violation] itself. Is there any violation of the antitrust laws that would give rise to a Section 2 Sherman Act claim in this case?

Justice Scalia: But you're asking us to do this in a case where a plaintiff without a real interest may be the one that's demanding that adjudication. This is very odd.

This morning our distinguished panel will illuminate what the Solicitor General calls something the Supreme Court refers to as antitrust injury.

Our first speaker is John Desiderio. John is an antitrust practitioner in New York City. He is a former Chief of the New York State Attorney General's Antitrust Bureau, and is the immediate past Chair of the New York County Lawyers Committee on Trade Regulation.

Our second speaker will be Dr. Janusz Ordovery. Dr. Ordovery is a professor of economics at NYU and a Director of Competition Policy Associates. He will discuss with us economics and antitrust injury.

Our third panelist will be Bill Rooney. Bill is an antitrust partner at Willkie Farr & Gallagher, and is the current Chair of the New York City Bar's Antitrust Committee. Bill will discuss with us antitrust injury, an exercise in legal teleology.

John Desiderio.

MR. DESIDERIO: Good morning.

David has said that the concept of antitrust injury is very elusive, and I intend to try to tell you why I think it is not so elusive. But I'm sure that Bill Rooney will give us all the reasons why it certainly is.

In any event, my role here today is to give you my perspective on a historical and chronological development of antitrust injury. In that regard I am going to start with what I perceive to be historical antecedents of the antitrust injury concept, what the Supreme Court has said antitrust injury is, and why they say it matters. I will conclude by telling you what I think the significance of the concept, as developed by the Supreme Court, has had to antitrust litigation since the *Brunswick* case.

Of course the reason we are talking about antitrust injury to private litigants is that, first of all, we do have antitrust statutes, the primary ones being the Sherman Act Section 1, Sherman Act Section 2, and also the Clayton Act Section 7 (which I neglected to include in these slides).

As you know, the statutory basis for private litigation for damages is in Clayton Act Section 4, which provides a remedy to any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws. Clayton Act Section 16 carries that same concept forward, providing injunctive relief for any person, firm or corporation entitled to sue for injunctive relief against threatened loss or damage by a violation of the antitrust laws.

So essentially then the question is: What is the harm caused by or threatened by an antitrust violation? What else could it be but antitrust injury? Yet as we know, there was no mention of the phrase antitrust injury in any cases of the Supreme Court until 87 years after the passage of the Sherman Act. In the *Brunswick* case, the Supreme Court gave us a definition. In fact, it gave us four definitions of antitrust injury. It says antitrust injury is injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendant's acts unlawful. It also says the injury should reflect the anti-competitive effect either of the violation or of the anti-competitive acts made possible by the violation. Finally, it should, in short, be the type of loss that the claimed violations would be likely to cause. That was in the context of a case brought under Section 4 for damages.

Nine years later the court made it very clear that the antitrust injury concept is required also in cases that seek injunctive relief. And, in fact, in *Cargill* it made it very clear that antitrust injury is a *sine qua non* of private litigation.

Now, here we are 27 years after the *Brunswick* case. Antitrust injury is a familiar concept to all of us. Courts are routinely deciding whether the plaintiff's alleged harm constitutes antitrust injury; that is, harm the antitrust laws were intended to prevent. Or whether the alleged harm is of no concern to the antitrust laws. Which raises the question: What was the state of antitrust law before *Brunswick*? Did the Supreme Court suddenly judicially legislate something into the concept of antitrust law that was not there before? Or did the *Brunswick* case really articulate principles that were always part of antitrust law? I believe it did the latter. Nevertheless, whether or not such elements or concept had been present in the interstices of antitrust law before *Brunswick*, there is no doubt that *Brunswick's* articulation of the concept brought about a revolutionary effect on proving injury in antitrust cases. It certainly expanded the role of economists in antitrust litigation in terms of proving injury.

In pre-*Brunswick* times, the role of economists was primarily limited to developing a theory or measure of damages in the injury phase of the case. Obviously, economists were always very much involved in helping to prove a conspiracy or at least a showing that there were elements of fact that pointed towards conspiracy and other elements of monopoly. But in terms of proving damages, their role was pretty much limited to what the measure of damages will be.

After *Brunswick*, obviously, the role of the economist is much greater. And that's why Dr. Ordoover is here today, to help tell us all how to use economists for proving anti-competitive effects or disproving the fact that there are or have been any anti-competitive effects.

So the question has become: Has the plaintiff suffered damage that the antitrust laws were intended to prevent? And then we ask the question: What exactly were the antitrust laws intended to prevent? The *Standard Oil* case in 1911 laid out a very lengthy history of the common law in England and in the United States as to how antitrust law developed. Primarily in England it was a reaction to the monopolies that the king had granted to various favored persons over the years, and, as a result of those monopolies, there were perceived evils that flowed from those monopolies. And here we have in the *Standard Oil* case a statement that "the dread of enhancement of prices and of other wrongs which it was thought would flow from the undue limitation on competitive conditions . . . led, as a matter of public policy, to the prohibition or treating as illegal all contracts or acts which were unreasonably restrictive of competitive con-

ditions.” That language was clearly echoed in the *Brunswick* case.

The evils that were perceived to “flow from” monopoly were the power to fix prices, the power to limit production, and the ultimate deterioration in quality that was perceived to follow whenever there was a monopoly.

In the United States, obviously society had progressed beyond the agrarian stage that existed in England; in the late 1890s we were in the industrial age and the era of the trust system, which prevailed in many industries. We all know the abuses that flowed from them.

In the legislative debates, leading to the passage of the Sherman Act, Senator Sherman himself recognized that “society is now disturbed by forces never felt before whose sole object is to make competition impossible, control the market, raise or lower prices, as will best promote its selfish interests, and it is the kind of combination we have to deal with now.”

In his speech supporting passage of the act, he made a significant statement about what would be necessary to prove a violation. He says, “In providing a remedy, the intention of the combination is immaterial . . . if the natural effects of its acts are injurious, if they tend to produce evil results, . . . it may be restrained with a penalty or punished with damages.”

The early Supreme Court cases, as we know of course, did not characterize the injury that plaintiffs brought to the courts in those days. One example is the 1904 case of *Montague v. Lowry*, where the Court discussed the facts of the case. A cartel, a conspiratorial cartel of tile manufacturers and tile distributors in the San Francisco area, would not sell tile to independent tile distributors unless they paid 50% more than the price at which the cartel members themselves were able to buy the tile. Obviously, it was designed to ultimately either drive the independents out of business or make them pay higher prices. Those were the facts the Court discussed. It was a very fact-specific opinion. But in speaking to those facts, it basically identified the elements of the plaintiff’s harm, which were, in Senator Sherman’s words, the “natural effects” of the defendants’ acts, and in the words of the *Standard Oil* Court, it was the harm that “flowed from the undue limitation on competition.”

Now here we are a century after *Lowry*, and two recent cases from the Third Circuit involve similar distributor relationships. The *Rossi v. Standard Roofing* case obviously does not involve identical facts, but it is nevertheless a very similar situation. There was a boycott initiated by competitors of a roofing distributor to prevent his supplier from supplying him with the roofing materials that he needed to do business. Ultimately, he went out of business. And in *Carpet Group International v. Ori-*

ental Rugs, an association of importer wholesalers of oriental rugs brought pressure upon the foreign manufacturers of oriental rugs to not show their wares at a trade show that the Carpet Group wanted to organize that would be aimed at retailers who would buy directly from the manufacturers rather than through the importers and the wholesalers.

In both cases, the courts held without very much difficulty that there was antitrust injury. And it seems to me there is nothing new under the antitrust sun, even after 100 years.

As time passed and antitrust litigation matured, in the early- to mid-twentieth century, some of the language in the Supreme Court cases started to take on the kind of more-focused attention to the elements of harm that we ultimately see in *Brunswick*. One case that I would point to is the *Story Parchment* case in 1931, which was a predatory pricing case designed to drive out competitors. In the context of whether or not the plaintiff had proven enough to prove his damages, the Court said that the natural and probable effect of the combination and the price cutting would be to destroy normal prices. And this was the kind of injury that *Brunswick* would later say reflected the anti-competitive effect of either the violation or of the anti-competitive acts made possible by the violation.

The next major case that foreshadowed the *Brunswick* ruling was *Zenith v. Hazeltine* in 1969. That was a case involving a patent pool that was operating in Canada. And basically, as a result of the agreement between the members of that pool, they effectively excluded the Zenith Company from doing any business in Canada. The Court said the injury alleged by Zenith was precisely the “type of loss that the claimed violations of the antitrust laws would be likely to cause.” And these were the exact words that you find in the *Brunswick* definition of some eight or nine years later as one definition of antitrust injury.

But strangely enough, the case that most clearly foreshadowed the *Brunswick* decision was not written by the Supreme Court, but it was written by the Second Circuit in *GAF v. Circle Floor*, in 1972, a merger case brought by GAF to stop a takeover by Circle Floor. The Second Circuit looked at the claims that GAF made and said, preliminary to its decision, that whether viewed in terms of lack of standing or the absence of “antitrust damages,” the courts, in denying recovery to various kinds of plaintiffs, have sought to confine recovery to those who have been injured by restraints on competitive forces in the economy. And the phrase “antitrust damages” is underlined and emphasized by the Second Circuit in that case. As it turns out, the Second Circuit decided that GAF was not injured by reason of the violations it had alleged under Section 7. It said only a person whose competitive

business position is harmed by anti-competitive effects of the alleged restraint can maintain a treble damage action. GAF's damages were not the economic result of the anti-competitive effects of the alleged violation. So the anti-competitive effects of a takeover would be felt not by GAF but by competitors of GAF and of Circle Floor. It ultimately concluded, therefore, that there were no *antitrust* damages because there was no diminution of GAF's competitive position. And again, I point out that the italicization of "antitrust" is by the Second Circuit.

Indeed, the Supreme Court itself cited the *GAF* case in deciding *Brunswick*, and it most certainly must have been a very substantial case on which it relied.

Now, *Brunswick's* teachings are, first, that causation is not enough. There had always been cases involving antitrust standing where the courts said that merely being able to trace some injury to an antitrust violation does not necessarily confer standing. But in *Brunswick* it went further and said basically that an injury that is arguably traceable to an antitrust violation does not automatically qualify as "antitrust injury." So therefore the courts must distinguish between loss that occurs by reason of a violation and loss that occurs by reason of that which makes defendant's actions unlawful.

The Supreme Court tried to further explain what it meant by all this in *Atlantic Richfield*, where it explained that antitrust injury arises only from the anti-competitive aspects of a defendant's conduct. Requiring antitrust injury ensures that a plaintiff's claimed harm corresponds to the rationale for finding a violation of the antitrust law in that particular case. Requiring antitrust injury prevents plaintiffs from recovering damages or equitable relief for losses caused by lawful competitive conduct, and ensures that plaintiffs can recover only for losses caused by competition-reducing aspects or effects of a defendant's behavior. And any possibly pro-competitive or efficiency-enhancing aspects of even a nominal antitrust violation have no role in the definition of antitrust damages.

As we recall, in the *Brunswick* case a chain of bowling alleys that was failing had been acquired by Brunswick, primarily because it owed Brunswick a lot of money and was going bankrupt. So Brunswick acquired the assets of the bowling alleys to keep them in business and obviously get some return on its loan. But the competitor wanted the court to find that to be a violation, because if the chain of bowling alleys had gone out of business, the competitor was going to increase its market share. As we know, the court said that's not the kind of injury that flows from the violation. Even if the merger itself was a violation, the competitor had no right to seek profits that it would have lost because of increased competition. And *Atlantic Richfield* further clarified the meaning of antitrust injury.

In terms of *Brunswick's* legacy, I think over the years it has made the courts and the bar focus on antitrust essentials both for antitrust standing and antitrust liability. As we know, in the *Blue Shield* case as well, *Blue Shield v. McCready*, the Court said that antitrust injury takes many forms and applies to all antitrust violations.

While an increase in price resulting from a dampening of competitive market forces is assuredly one type of injury, for which Section 4 potentially offers redress, that is not the only form of injury remediable under Section 4. In fact, there is a recent case decided here in the Southern District, *Redding International v. Oak Tree Capital*, decided, I believe, December 1st, which illustrates that a single plaintiff in a single case may have antitrust injury from one alleged violation at the same time that a court can find it has not suffered antitrust injury from another violation. That was a case where the plaintiff, which was the Village East Cinema Film Theater, brought a Section 7 claim against two major competitive theater chains, alleging that mergers that had occurred over a 15-year period outside the New York City market had caused those chains to acquire such power as to cause an anti-competitive effect on Village East in lower Manhattan. However, the court held that no antitrust injury flowed from whatever unlawful mergers may have occurred in other localities, including as far away as Europe and Thailand, I believe. But at the same time the court held that the plaintiff had alleged sufficient facts to show that it may have suffered antitrust injury that flowed from a Section 1 violation involving agreements and arrangements between the Village East's competitors and the investors in those competitors.

In the materials, at page 138, there is a series of cases that indicate the various kinds of antitrust injury that may exist under different kinds of antitrust violations.

Obviously, we know that antitrust injury has been used as a proxy for antitrust standing since *Brunswick*. The courts have increasingly relied upon that as a means of weeding out cases that should not have been brought. "Antitrust injury" is basically a much better test, a much more sensible test, than any of the tests that preceded it, such as "target area" or "zone of interests."

In *Associated General Contractors*, the Supreme Court attempted to lay out six factors it said the courts should use in determining antitrust standing "in each situation." But as the materials show, the courts for the most part have ignored the directive of *Associated General Contractors* that courts examine each of the six factors in each case. The courts have tended more to follow what the Second Circuit said is a two-prong test: First, decide whether or not there has been an antitrust injury; then, decide whether it is a competitor case—where for the most part you're not going to need to get into the other AGC factors—or whether it is a consumer case, where

the *Illinois Brick* and indirect injury and potential complexity of damages issues might need to be addressed.

Distributor cases are sort of a hybrid. Certainly where it is clear that the competitors are the driving force behind the violation, the courts tend to find the antitrust injury relatively easily. However, there may be possible indirect injury issues, such as in the *Redding v. International* case.

To conclude, as I'm running out of time, I'll just say we know that antitrust injury was not formally defined until 1977. But the elements of the concept have been part of the law from its very inception.

Antitrust injury has required a lot more economic analysis. Antitrust injury has indeed become the threshold focus of the antitrust standing inquiry. And that situation, I don't believe, is likely to change in the foreseeable future.

In *Verizon*, we know the Supreme Court avoided deciding anything about the antitrust standing issues, although Justice Stevens said he would have dismissed the case on standing grounds. But even he, I think, has come around to the way the Second Circuit looks at things. Although Justice Stevens may not have believed that *Trinko* had suffered any antitrust injury, he nevertheless said that, if there was antitrust injury, it was antitrust injury that was derived from the antitrust injury suffered by AT&T in the first instance, and, on that basis, *Trinko* lacked antitrust *standing*. Aside from "antitrust injury" and the "indirect injury" factors, Justice Stevens did not refer to any of the other six AGC factors.

Thank you.

MR. HAYES: Thank you, John.

Our next speaker will be Dr. Janusz Ordovery.

DR. ORDOVER: Thank you and almost good afternoon. I always thought that economics is enough of injury to antitrust lawyers. To combine economics and antitrust injury is probably more than anyone can stand at this time before lunch.

What I wanted to talk about is, first of all, I want to share with you the total mystification as an economist as to these theological or Talmudic attempts to decipher exactly what this thing called antitrust injury is all about. I feel myself comfortable in trying to understand the issue of damages, but beyond that, the link between the conduct and the concept of injury is something that's pretty best left for antitrust lawyers. But for the fact that we, people like Meg and I, get thrust into these litigations and have to offer whatever insight we can in the process.

My task today actually could be taken along various lines. I could speak to the basic understanding of eco-

nomics as an organizing set of principles that enable one to ascertain the consequences for competition of any particular set of allegedly anti-competitive conducts, and then trace from those alleged effects on competition the economic impacts on various actors that are affected by that conduct. So, for example, in a price-fixing case, the economic theory focuses on the lessening of rivalry that normally would exist as between two, three or more firms that would describe for consumers, that would offer attractive prices, attractive services, high-quality products and so on and so forth. Yet in the presence of price fixing, that kind of competition, which we do believe to be beneficial, is distinguished not with the effect of reducing profits to the firms that have engaged in that kind of conduct, just the opposite, but with the effect of reducing the economic welfare of those who are affected by the diminution of competition.

So when you're thinking about it in the simplest case, when you're thinking about the economic theory of antitrust damages, the economic analysis is relatively straightforward. We do know that competition is beneficial, among firms is beneficial. Extinguishing of that competition could be harmful. It not always is, but when the reduction in competition takes the result of an agreement on price, then in principle that could be an outcome that is adverse to consumers, and therefore consumers will suffer some sort of damage or injury from that lessening.

Now, the situation gets somewhat more complicated, from my perspective, in the world of monopolization cases. One example, includes unilateral firm conduct vis-a-vis its potential rivals that in fact is the source of potential concern. So in an *ITS v. Kodak* case, which I was involved in, although unfortunately for Kodak, although proud to be involved for Kodak, the allegation was that Kodak refused to sell its proprietary parts for the copiers to the independent service organizations. Now, the effect of that decision allegedly was to render these ISOs less competitive. So the economic theory that was propounded, that had Kodak been willing to sell these parts to the independent service organizations, not only would these people be able to actually compete against Kodak, and that's the key thing, the consumers would in fact end up being better off. Okay, so again, here the economic theory is quite a little bit more complicated, because we have now a sequence of players or economic agents who are affected by the allegedly anti-competitive conduct at issue. We start with Kodak refusing to sell parts that apparently affects the business viability of independent service organizations, and that in turn allegedly has impact on consumers. Antitrust laws are designed to protect consumers, not competitors. They are designed to protect and facilitate competition, not the easy life of rivals. And *Trinko* makes that very clear.

I did file an amicus brief in that case, which was also disregarded. I guess I'm not doing too well. But be that as it may, what an economist has to do is try to clearly articulate the nature of the business conduct at issue and try to trace down as far as possible the economic consequences on competition from that particular conduct and ultimately on those economic agents who are the protected category of agents under the antitrust laws. That's the way I think it ought to be done.

Now, generally or frequently, all of these steps are not clearly spelled out. In fact, they are often very, very murky. For example, in the *ITS v. Kodak* case, which serves as a useful fulcrum for thinking about a lot of stuff, it was not spelled out as to what were the prices that actually Kodak was supposed to charge for these parts. So if you're thinking about the anti-competitive injury and anti-competitive effects, well, those clearly are going to be geared to what it is that is permissible under the antitrust laws in terms of the prices that someone like Kodak ought to be allowed to or required to charge for its proprietary parts. An issue that, of course, Justice Scalia addressed in *Trinko*. He said we are not very well equipped in trying to figure out how much someone should be charging, should be allowed to charge for some scarce or valuable assets that cannot be obtained from somewhere else. We don't have a sound basis for deciding what these prices ought to be. So he said let the regulator do that. Now of course in *ITS v. Kodak* there was no regulator that would step in and say yes, Kodak, you are supposed to charge so much for products and not something different.

The point I'm making here is the extent of the analysis of the economic effects has to be spelled out fully. One cannot, for example, argue that the ISOs would have been able to operate profitably in the market if Kodak were to be allowed to charge any price that it wanted. After all, they could have charged a million dollars for this little doo-dad that you need in order to make copies. If you charge a million dollars for the doo-dad that you need to make copies, nobody can effectively compete against Kodak, which implicitly does not charge itself that much. So once you got to the point of saying there is some liability flowing from that refusal to deal, you then need to figure out exactly what is permissible. And this is again the role that economists have often tried to preserve for themselves. And, in fact, I do have economic theory which tells you how much Kodak should be allowed to charge, but maybe I'll come back to that in a minute.

Let's take another case that I am somewhat more prouder of, and that is *U.S. v. American Airlines* or *AMR*, in which I worked for *AMR*. In that case the competitive economic theory was that of anti-competitive pricing or potentially capacity expansion. Okay, well that's a well-defined concern that we have. And there may be some

economic effects that will flow from the fact that perhaps *AMR* charged too little or expanded capacity by too much in response to these competitive incursions by rival airlines into its hub at DFW. Fine and dandy. But surely, during the period of predation, the consumers were much better off than they were potentially before, because prices fell and there was more capacity on these contested routes.

So now we have a problem again, which is to say that the protected class, that is of consumers, somehow is supposed to be protected not by allowing these competitions to flourish, but rather by requiring the competition being in some way diminished, and by which I mean by making sure that someone like American Airlines is not allowed to do whatever it pleases, whatever it chooses to do in place of a competitive entry by a rival. So what begins to sound like the flip side of antitrust, the antitrust is supposed to protect consumers from exercise of market power. Yet apparently in this case it is viewed as being the source of protecting the rival against the competitor prowess of American Airlines.

I don't want to sound like an advocate, because obviously we do have a well-developed law of predatory pricing, which maybe after *American Airlines* and *Northwest, Spirit v. Northwest* in the airline industry may be actually nonexistent. But the point I'm making is that in order to link injury to these kind of concerns that the antitrust laws spell out, we have to actually be very clear as to what is the object that is being protected. The object that is being protected is competition, not competitors. And if competition is protected, then we hope that consumers ultimately will be the beneficiaries. The trick is, obviously, as I pointed out in this American Airlines example, that the short periods of competition may lead to a period of protected or persistent or enhanced monopoly, and that's a trade-off between competition now and competition in the future that obviously creates the kind of analytical concerns that we have.

Anyway, assuming that antitrust liability theory can be identified, can be formulated sufficiently rigorously, then one has to move on to the next bullet on my little slide here.

By the way, I am holding Meg responsible for these slides. She was kind enough not to blame me for her slides. I'm blaming her because I stole everything that I know from her. So thank you, Meg, I appreciate the sharing of intellectual property right.

The economic models and analysis that I am speaking of, I want to say a word or two about right now, are those that try to actually trace down the competitive effects from the allegedly challenged conduct. It is actually relatively easy to do if you think about it in a price-fixing case. Relatively much easier than it is in Section 2 or some sort of monopolization case. And the reason for

that is that, again, we have a well-developed body of economic thought that tries to link reduction in competition through horizontal coordination to price impacts. Now, I'm not saying that that body of economics is sufficiently well developed. One can look it up in the economics cookbook and say okay, this is what happened and that's what the effect is. No, far from it. In fact, the economic analysis now that we have been developing to analyze the economic consequences of, for example, price-fixing agreements, explicit agreements, have become extremely sophisticated. And I don't want to be rushing through slides, so I'm just going to be talking and you can look at the slides later on.

The economic theory that underlies those kind of models is of great sophistication. By which I mean that the economic theory or the telemetric theory that underlines these kind of models tries to infer from the historical or the but-for event what would happen but for the violation. So take the simplest case of a vitamins cartel, and in the vitamins cartel there was an allegation that there was a manufacturer of vitamins, who actually pled guilty, raised the price of vitamins by some substantial amount. That's great. We know where the violation is. We know what the object of the conspiracy was, to increase price, and now we are trying to figure out exactly what the impact of that was and on whom.

Now, that turns out to be actually a complicated exercise mathematically, statistically and economically. Why? Because we don't know what the world would look like but for the violating. We have to make it up. And when we have to make it up, we have to adhere to very high standards of objectivity and rigor in order to make the assessment. Now, one can simply say hey, look, the price was ten dollars per kilo of Vitamin C, so it should stay ten dollars per kilo of Vitamin C for the next ten years. Now, if someone were to say that to me on the class that I teach on Mondays and Wednesdays, Industrialization and Economics for Undergraduates, I would say the person is an idiot. But since I am not allowed to say such things under oath, I would say the model is flawed. That's the equivalent of what I was going to say. So when you say the model is flawed, you basically say that there are some deep problems with the tool that is applied.

For example, the assumption of stability of price over a very long haul just makes no sense. And because it makes no sense, an economist is compelled to dig deeper and uncover from the historical evidence or some other evidence what the price would look like but for that agreement. Try to remove the effect of the agreement on price.

There are several strategies we can use. One strategy is to simply build a little forecasting model that says look, if I think that the price last year was a dollar in the year before the conspiracy, and the next year it was

eleven dollars, then I can figure out why the price went up from ten to eleven by looking at such things as changes in underlying costs, maybe scarcity of some input into the production of the vitamin and so on and so forth. So I can build into my forecasting model, the same way Chairman Greenspan builds into his forecasting model for interest rate, all those kinds of things of interest to an economist. Then I can test statistically whether this makes sense. So when it comes to forecasting but-for prices, it is useful to develop these econometric tools of using regression analysis. That is a way of characterizing the available evidence as a means for telling what things would be like, and then run that model through the time period of the conspiracy. That's a great exercise; it is a very well-defined exercise, but it has some problems. Sometimes those problems are minimal and can be disregarded, depending on what the standard of proof is that the plaintiffs require in such a case. In other cases it may be much more complicated.

So let's assume in our stylized example that somehow three years into the alleged conspiracy somebody's plant blows up. Well, if you were to be running that simple forecasting model, you would fly over the blowing up of the plant, the removal of the capacity, and say that that year the price ought to be ten dollars or eleven dollars or whatever. Well, it turns out the plant blew up and 25% of the capacity got lost for a year and a half. Well, surely we as antitrust economists and now part of this legal community—to be an associate member of the ABA, I can say that—we would say that's not right. Something has to give. So what you have to now begin to do, when you're looking at trying to trace the economic impact of that collusive agreement, you have to factor in or factor out the effect of this removal of the capacity from the market and try to figure out what the price will be with that capacity out. Again, sounds simple but brutally complicated. Why is it brutally complicated? Because it requires that you make explicit the economic model of competition that you think would have taken place with 25% of the capacity removed; with firms knowing that there is potential unavailability of product and how would they react to that?

So what I am suggesting is that even in the simplest of these circumstances, in which there is a well-defined statistical approach to forecasting or predicting price, the answers may very much depend on the extent to which you want to introduce the well-known developments during the period of the alleged conspiracy.

Now, in order to make your head spin and my head spin even more, you can say to yourself, wait a second, the effect of the conspiracy has not only been on prices, but potentially on other aspects of firm decision making. For example, how much capacity did they put in? Had they not included, some might say, there would have been 25% more capacity and the reduction in the fact that one plant went out would have much less of an

impact than the world in which capacity was potentially restricted. So again, when we are thinking about the effects of anti-competitive conduct on the protected class, the class that we are concerned about here, consumers, we do need to spell out working with the business people, working with the lawyers, working with economists, the best description of the but-for world that both comports with the actual facts and also with the facts that we import from somewhere else in order to make our predictions.

Let me just finish up by having two minutes, so I'll just take one. And what I want to ask you is the question. Go back to the *American Airlines* case. In the *American Airlines* case the allegation again was of anti-competitive pricing through depressed fares, but also through the fact that American Airlines added a large number of flights on certain routes. Okay, well, we know this potentially is or is not anti-competitive. Now if the only thing you are asking is injunctive relief, which is what the government would ask, which we would say look, you're not allowed to do X, Y and Z. Okay, fine. But what happens if you're coming in as a private client seeking damages? That becomes a complicated problem because now you have to work with an economist, and your business people to try to construct the but-for world of competition out of Dallas/Fort Worth that would not be anti-competitive. How many flights should American Airlines be allowed to add in? Professor Stissing said that American Airlines should have removed flights, not added flights. Well, how many flights could have been or should have been removed? Is there a consensus of that? No, there is a great consensus if somebody tries to compete against you that maybe you should improve the quality of your offerings, such as flying more often as opposed to flying less often. So what I'm trying to paint for you is that in each and every case that you are confronting in your daily practice, the interplay between economics, business and law is extremely close and extremely intricate. It requires full spelling out of the permissible or impermissible conduct and trying to trace out the effects of what's permissible and what's not permissible on those whose interests the antitrust laws supposedly ultimately protect, which is consumers. Unfortunately, or maybe fortunately, in most cases it is not the consumers that go in and sue, but often it is the parties that are, in fact, the rivals of the firm that has engaged in anti-competitive conduct. In that context, we have to understand how it is the injury to the rival that is going to ultimately affect those that the antitrust laws are designed to protect, which is people like you and I.

Thank you.

MR. HAYES: Thank you, Janusz.

Our final speaker will be Bill Rooney.

MR. ROONEY: Thank you David. I must say it is a real pleasure to be here this early afternoon with so

many sophisticated and experienced antitrust lawyers that I see in the audience, to discuss such a rich, if elusive, topic as antitrust injury. Well, I mean, is it elusive.

I would like to ask how many think antitrust injury is among the ABCs of antitrust law? How about a show of hands, how many think it is among the ABCs of antitrust law? How many think it is the Rubik's Cube of antitrust law? Well, if we can crack the code of antitrust injury, I submit that it will shed more light on antitrust law than any other single doctrine in the books.

Now going last, of course, poses the risks of some repetition. But let us just call it circling back. I will try to take more of a macro view and answer or address three questions this morning. What is antitrust injury? How does it fit in antitrust law? And what problems can it help us solve that we are confronting in today's unsettled law? So first, what is it? Antitrust injury is an element of the cause of action. It is as much an element of the cause of action as injury is an element of a tort cause of action. It is part of but distinct from standing, which we may have a little bit of a nuance of difference among the panelists both on the object of the antitrust laws and on the relationship between antitrust injury and standing here. I think it is part of but distinct from standing. The standing question is, what person is the proper antitrust plaintiff? The antitrust injury question is, what injury is cognizable under the antitrust laws? Now, they are not unrelated. Antitrust injury is a necessary, but not sufficient, condition to establish standing. If you don't have antitrust injury or if you don't plead antitrust injury, you have not established standing. If you plead antitrust injury, you may or may not have antitrust standing, depending upon other prudential concerns, such as remoteness.

Still, what is it? What is antitrust injury? Antitrust injury is a subset of injuries in fact that are linked to a market injury. It is a subset of injuries in fact that are linked to market injury. Says who? Well, we would start, I suppose, with Section 4, which John quoted earlier on. And yes, indeed, I think it is the by-reason-of language. And again Section 4 is any person—and person is where the standing analysis comes in—who shall be injured in his business or property, injury in fact by reason of—here comes antitrust injury—anything forbidden in the antitrust laws.

Now we go to *Brunswick*, that sometimes maligned, many times cited, often described as opaque, impenetrable, circular opinion of the Supreme Court that really started this all off. Notwithstanding the historical origins that John rightly points out, *Brunswick* says: It is quite clear that if respondents—that is the competing bowling alley—were injured, it is not, and they quote “by reason of anything forbidden in the antitrust laws,” thereby pinpointing the portion of Section 4 from which antitrust injury derives. While respondents' loss occurred by rea-

son of the unlawful acquisitions, it did not occur by reason of that which made the acquisitions unlawful.

We now have by the by-reason-of language, a link between the injury in fact and that which is prohibited by the antitrust laws. Well, what's that, and that leads us to the title, as it were, of my outline, which is an exercise in legal teleology. Teleology of course is the study of ends and objectives of things and attributing significance to things by virtue of their end. The end of the eye is to see. The excellence of the eye is to see well. So what's the end of the antitrust laws? Well, *Brunswick* again helps answer that question by helping to establish the ever-loved mantra of antitrust law, it is to protect competition, not competitors. First quoted, I believe in *Brown Shoe*, which is often not thought to be the beginning of either antitrust injury or focusing on market injury. *Brunswick* goes on to say: The injury should reflect the anti-competitive effect either of the violation or of the anti-competitive acts made possible by the violation. Quoted many times, and indeed by John this morning.

Now, that formulation itself may not be crystal clear. But one thing that is clear about it is the focus on anti-competitive effect. So we now have the object of the antitrust laws having to do with eliminating conduct that causes anti-competitive effects. And for short I will call that a market injury. So we now have the by-reason-of language forming a link between the injury in fact and a market injury.

But which way, pray tell, must the causation go? Must the injury in fact be caused by the market injury? Or must the market injury be caused by the injury in fact? I would say that the causation can run either way. That is, an injury to a rival can indeed cause a market injury. On the other hand, a market injury can certainly cause an injury to consumers. So we properly have an equal sign between the injury in fact and the market injury flowing from the by-reason-of language.

Now, as I was thinking about this subject, I was tempted to do it slightly differently and to try to describe more fully why I think antitrust injury lies at the heart of the antitrust revolution that began about 25 years ago. And the reason for that is that it identifies as the centerpiece of an antitrust violation, that is the doctrine of antitrust injury, identifies as the centerpiece of an antitrust violation a market injury. And the last 25 years have seen an increasing influence of microeconomics, and hence the proper presence and well-appreciated presence of Janusz here this morning, of microeconomics in defining what a market injury is, when it has occurred and when it can occur. Microeconomics has helped inform market definition, which also is directly important and relevant to whether the plaintiff has suffered an antitrust injury. What's the plaintiff's relationship to the defined market? They have helped with market power in

determining when a market injury can occur. So that's what it is.

How does it fit in antitrust law? Well, again for standing, it is part of but distinct from standing. Cases like *Associated General Contractors* and *Illinois Brick* I view as standing cases, addressing the larger question of who is the proper plaintiff. Cases like *Brunswick*, *Cargill* and *Atlantic Richfield* I view as more specific antitrust injury cases, examining the quality of the personal injury and determining whether it is sufficiently linked to the market injury.

Now, how about *Verizon* and the dialogue that David quoted at the outset between the Solicitor General and Justice Stevens? Well, the concurrence lets us know that Justice Stevens held tight with his view, that you can assume the violation and yet still conclude that the plaintiff is not the proper person to bring the claim in that case, because the plaintiff's injury is entirely derivative of the rival's injury—which would be at least one paradigm in which the market injury would be caused by or result from an injury to a rival. The proper plaintiff, if there is a claim at all there, would be AT&T. And according to Justice Stevens, the consumer buying services from AT&T was one step too far removed. So to try to again place these concepts of standing and antitrust injury on the landscape, it seems to me that the concurrence in *Verizon* is speaking more to standing than it is to antitrust injury. Though far be it for me to deny that the relationship is not very close.

For example, *McCready* is a case in which both remoteness as well as the quality of the injury are discussed in seriatim. So the concepts clearly run together, but in helping to distinguish one from the other, it seems to me the Solicitor General, in the *Verizon* argument, did not fully appreciate the difference that Justice Stevens was making. And that is between standing, more generally, and antitrust injury more particular.

In the per se context how does antitrust injury fit? Well, it still must be pled and established. *Atlantic Richfield* hits that head on, and I think that that case, perhaps more than any other, gives a full and rich description of antitrust injury and also offers us a more sophisticated appreciation of commercial conduct insofar as observing that most commercial acts can have at least three sorts of consequences: an anti-competitive one, a pro-competitive one, and a competitively neutral consequence. It is up to us to distinguish among those consequences, identify the anti-competitive consequence, if any, and determine the link between it and the plaintiff's injury.

In the Rule of Reason context, of course, market injury has its fullest and most complex discussion in terms of market definition, market power, market-wide impact and examination of the impact that anti-competitive effect, if any, had on the injury pled by the plaintiff.

The Section 2 context has not received a lot of discussion of antitrust injury, but it is quite interesting, I think. We start with a context in which there is a monopolist, or at least we will assume there is a monopolist. You must plead and prove monopoly power and the use of exclusionary means to maintain monopoly power. It is essentially a means statute, not an ends statute. So if we assume monopoly power, we have already assumed a market structure in which there is a competitive injury. And the only question is whether that market structure is being maintained by exclusionary or anti-competitive means. The law will tolerate that market injury if it was achieved through pro-competitive or output expanding means. If it is achieved or maintained by exclusionary means, the law does not tolerate that market injury. And if the rival can show that, first, there is a monopoly and, second, its personal injury results from an exclusionary conduct by the monopolist, I believe that rival has established antitrust injury for purposes of its Section 2 claim.

With respect to Section 7, I think the courts are quite skeptical of rivals being able to establish antitrust injury, and the main reason for that I think is they don't view the act of merging as an exclusionary act. Sometimes in vertical cases, where the merging companies control distribution systems, the rival can claim that the act of combining these distribution systems will have a foreclosing effect on the rival's ability to get to the market. And it seems to me that has the beginnings of a claim that may sound with antitrust injury.

Now, as time is escaping, let's move onto what problems antitrust injury might solve. First on the list is target standing. Most courts seem to believe that targets don't have antitrust injury, because, first, if the merger is anti-competitive, they will be part of the larger entity that is enjoying the monopoly rents, so perhaps there is no injury in fact. And, secondly, their injury does not depend on whether or not the merger is anti-competitive. They will suffer the injury, which apparently is the loss of independence, whether or not the merger violates Section 7.

Now, we can go back to *Brunswick* to appreciate a little bit of prescience here. When *Brunswick* says of the rival's injury in that case, while respondent's loss occurred by reason of the unlawful acquisition, it did not occur by reason of that which made the acquisition unlawful. And that language may be particularly applicable to the problem of target standing.

Now we come to the Second Circuit, of course, which recognizes target standing. And I think John's discussion of *GAF* is particularly interesting. I don't recall *Con Gold* discussing *GAF* at all, and yet it is a binding decision of the Second Circuit on the court in *Con Gold*. But in any event, *Con Gold* finds that the loss of independent decision making is the antitrust injury that results from the transaction or from the merger and gives the

target standing. But query whether a change in form is really an injury either cognizable under the antitrust laws or at all, when that change in form is compensated at market value. Because presumably the shareholders will not enter into the offer if the tender price does not compensate them at market value for the shares, for the change in control.

More recently, the airline case—*Mesa*, in the District of Columbia—addresses target standing in the context of a proxy solicitation and finds that because the shareholders would have to elect the directors who will then opt for the merger, there is consent to merger; and with consent one cannot complain of an injury. I thought it was a very interesting concept which I think more importantly does apply to the proxy solicitation context but also has some application to the tender offer context, where the shareholders will voluntarily proffer their shares at market value in return for change of form of the corporation.

Now the second problem that may be addressed by antitrust injury is buyer liability under the Robinson-Patman Act. As you know, under Section 2(f) one competitor may sue another competitor for knowingly receiving or inducing a discrimination and price prohibited by the Robinson-Patman Act. What's essentially happening here is that one competitor is getting the higher price and the personal injury is clear enough. But if we go back to the answer to the question of what is it; where is the market injury on the other side of the equal sign? One can say the Robinson-Patman act is different because you're suing for damages under Section 4 of the Clayton Act and running square into the by-reason-of language which links personal injury to market injury. And we also know that antitrust injury will be applied to the Robinson-Patman Act as *Brooke* group was basically a primary line price discrimination case.

So as buyer liability has not yet made elements of that cause of action, either that the defendant had buyer power or that the defendant with buyer power had exercised that power to preclude the plaintiff from getting the same low price, one wonders whether there is a fit between 2(f) and antitrust injury. And one also asks the question, if one requires for buyer liability both buyer power and a mandate that the rival not get the same low price, whether we can make consistent Section 2(f) of the Robinson-Patman Act with the rest of antitrust injury doctrine under Section 4 of the Clayton Act.

Well, that's it for now. Antitrust injury in a nutshell, I suppose. And I look forward to the questions to dig deeper into the issue. Thank you.

MR. HAYES: Who has the first question?

AUDIENCE MEMBER: Bill, you mentioned a couple of times in the first half of the presentation who was the proper plaintiff. There may be a hundred proper

plaintiffs. I think the question is: Is this particular plaintiff a proper plaintiff? Has he been damaged? Has he been injured? Has he been egregied?

MR. ROONEY: I totally agree. I don't intend to say the courts ought to ask in the abstract who is the proper plaintiff, but is this the plaintiff who is proper.

AUDIENCE MEMBER: Is the panel detailed to the standing issues (inaudible)

MR. HAYES: Let me try to summarize and repeat the question for the panel. In Justice Stevens' concurring opinion in the *Verizon v. Trinko* case, Justice Stevens and two other members of the court stated that the case could have been dismissed on what Justice Stevens called antitrust standing, rather than antitrust injury.

Does the panel want to discuss and elaborate further on Justice Stevens' concurring opinion in *Verizon v. Trinko*?

MR. DESIDERIO: Well, as I understand what he said, he assumed for purposes of I guess his very short opinion that there might have been antitrust injury. I don't think he really thought there was. But for purposes of what he wanted to say, since he wanted to focus on standing, he said that it was clear to him at least, that whatever injury the plaintiff may have suffered, if he suffered any injury, it was derived from the injury that was alleged or that AT&T would have incurred by reason of the anti-competitive, the alleged anti-competitive conduct of Verizon against AT&T. And you know, he went back to the *Darnell Tenzer* case, where Justice Holmes said we don't go beyond the first step. So in his view, and Justice Stevens' view has been very clear from the *McCready* case where he was a dissenter, even though he cited it very extensively in the AGC case, his view all along has been that standing is a very clear issue and that it has to be cut off. You just don't give antitrust standing to any injury that appears to derive from an antitrust violation. And he's very strict in terms of how he views the indirect and the direct type of injury. I just think he saw this as clearly an indirect injury, and he saw no reason to allow this plaintiff to have the whole Telecommunications Act interpreted because of one law firm.

MR. ROONEY: Yes, it also seems that if we read Justice Stevens' words, I think he focuses on complex apportionment, duplicative recoveries, remoteness and the fact that we are not going to be left without an antitrust plaintiff. He says, for example, unlike *McCready*, respondent who runs both the risk of duplicative recoveries and the danger of complex apportionment of damages, the task of determining the monetary value of the harm caused to respondent by AT&T's inferior service, the portion of that harm attributable to Verizon's misconduct, whether all or just some of the possible misconduct was prohibited by the Sherman Act and what offset, if any, should be allowed to make room for recovery that would make AT&T hold is certain to be daunting. AT&T, as the direct victim of Verizon's alleged misconduct, is in a far better position than respondent to vindicate the public interest and enforcement of the antitrust laws. Denying a remedy to AT&T's customer is not likely to leave a significant antitrust violation undetected and unremedied and will serve a strong interest in keeping the strong scope of keeping antitrust trials within judicially managed limits.

Now it is a judgment call as to whether he's right on that. But I think that was his rationale.

MR. HAYES: Thank you very much for your attendance this morning.

MS. ANTHONY: Thank you very much, David, and all of your illustrious panelists. It was great.

As I mentioned earlier this morning, we are going to have a short business meeting for those of you who are Section members. Before I segue into that, I do want to recognize a member of our committee, a former Chair who came in this morning, Commissioner Pamela Jones Harbour, who has joined us for the program. She will be with us all day and at the reception and dinner this evening. So there will be a chance to talk with her, to catch up and say hello.

It is great to have you here. Welcome back. We miss you.

All right, now I'm going to turn over the short business meeting, which involves the election of officers and new members, to Meg Gifford, who is going to take it from here.

Section Business Meeting, Election of Officers and Members of the Executive Committee

MS. GIFFORD: Thank you.

Good afternoon everyone. If you'll bear with me, this will take just a minute. The Section needs to nominate and elect the members of the Executive Committee and the officers for the coming year.

First, I want to thank the other members of the Nominations Committee, Steve Houck and Bob Hubbard, whose efforts resulted in a significant expansion of the committee this year with respect to membership outside of New York City and in-house membership, which has been a continuing goal of this Section.

So the Nominating Committee nominates the following current members of the Executive Committee for election to a one-year term to end on the date of the Annual Meeting in 2005. Barbara Anthony, Kevin Arquit, Michael Bloom, Linda Blumkin, Molly Boast, Barry Brett, Edward Cavanagh, Bruce Colbath, Lloyd Constantine, David Copeland, John Desiderio, Steven Edwards, Howard Ellins, Professor Harry First, Lawrence Fox, Martha Gifford, Ilene Gotts, David Hayes, Jay Himes, John Herfort, Stephen Houck, Robert Hubbard, Norma Levy, William Lifland, Joseph Lipofsky, Kenneth Logan, Steven Madsen, Saul Morgenstern, Kenneth Newman, Bernard Persky, Bruce Prager, Yvonne Quinn, Susan Raitt, Moses Silverman, Steven Tugander, Vernon Vig, Michael Weiner, and Alan Weinschel.

And the committee further nominates the following individuals as new members of the committee for election for the same term. Robert Anderegg of IBM Corporation of Somers, New York; Fred Aten of Harter, Secrest & Emery in Rochester; Jan Constantine, The News Corp. in New York City; B.J. Costello, Hinman Straus of

Albany; Elaine Johnston, White & Case, New York City; Peter Millock, Nixon Peabody, Albany; Tom Mueller, Mayer, Brown, Rowe & Maw, New York City; and Kevin Toner, Heller Ehrman of New York City.

May I have a motion to elect those members?

AUDIENCE MEMBER: So moved.

MS. GIFFORD: And a second.

AUDIENCE MEMBER: Second.

MS. GIFFORD: All Section members in favor? (Members voted aye).

MS. GIFFORD: Now, the Nominating Committee nominates the following members of the Executive Committee for election to one-year terms in the offices identified.

Barbara Anthony, currently Acting Chair, as Chair of the Section.

Steven Tugander, Vice Chair and Program Chair.

Ilene Gotts, Secretary.

May I have a motion?

AUDIENCE MEMBER: So moved.

MS. GIFFORD: Second.

AUDIENCE MEMBER: Second.

MS. GIFFORD: All in favor (Members responded aye).

MS. GIFFORD: Thank you very much. This part of the business meeting is concluded.

Overview and Economic Analysis of the Recent MasterCard/Visa Case

MR. CONSTANTINE: Good afternoon, and welcome to the afternoon session of the New York State Bar Association Annual Antitrust Section Meeting. My name is Lloyd Constantine, and I'll be the moderator of this terrific panel.

In 2003, three major antitrust cases involving competition in the payment systems industry were decided by courts or were otherwise concluded. In December of last year, Judge John Gleeson of the Eastern District of New York granted final approval to the settlement in the merchants' case against Visa and MasterCard. And earlier, on April 1, 2003, he granted summary judgment to the merchants on all of the elements of their Section 1 tying claim and several elements of their Section 2 attempt to monopolize claim against the defendants.

Also in December of last year, Concord, the owner of the Star ATM debit network, and First Data, which is the owner of Star's NYCE Network, capitulated to demands of the Antitrust Division and a group of state attorneys general, led by New York, to divest the NYCE network as a condition precedent for acquiescence in a merger of Concord and First Data.

Also, last September, the Second Circuit affirmed the decision of Southern District Judge Barbara Jones, rendered in the *United States* case, that Visa and MasterCard violated Section 1 by employing exclusionary rules which prohibited 8,000 banks, which are members and owners of both Visa and MasterCard, from issuing credit cards or debit cards on the American Express or Discover networks.

And I read in the paper today that in the wake of the Second Circuit's affirmation, and while there is still an issue of the stay in that case which is before the circuit, MBNA has just signed a contract or a letter of intent to issue cards on the American Express Network. And I also know that Morgan Stanley and Discover are out there currently attempting to do the same thing with a number of financial institutions.

On our panel are the economists for the merchants and government in these three cases, and the merchants' lead counsel will discuss the overlap and the perceived disagreement and collision between some of the economic analysis advanced by the successful plaintiffs in all three cases, and in particular the economic analysis of the product dimension of the relevant antitrust markets in these cases.

In the merchants' case we asserted and Judge Gleeson's summary judgment decision adopted a tying prod-

uct market comprised of—I love market definitions, they are just so long—"national general purpose credit and charge card services to merchants." And the court also adopted another definition for another market which was defined as "national general purpose debit card services to merchants." Since this panel will spend some of its time on market definition in these cases, it is probably worthwhile to deconstruct and further explain those two market definitions, because it will be the launching pad for all of the slightly different market definitions. So those two market definitions and all of their undulations will give you a launching pad for the somewhat different market definitions in the other two cases.

The merchants allege that Visa and MasterCard were tying the debit card services sold to stores to the dominant credit card services that they also sell to stores. The tying product market, credit and charge card services, had a geographic dimension national in scope, meaning that the cards are used throughout the United States and accepted for payments by all types of merchants, as contrasted with proprietary credit cards which can be used regionally or used at only a single store or a chain of stores, like a Sears credit card or Macy's credit card. The product dimension of this market included both cards with revolving lines of credit and charge cards which are also called sometimes travel and entertainment cards, or T&E cards, like Diner's Club or American Express. Such cards generally have no preset spending limits, and they have no revolving credit lines.

The merchants also affirmatively alleged a narrower tying product market limited to revolving credit cards. The court adopted the broader market. This tying product market, the narrower one, involved card services sold to merchants as contrasted with the services which Visa, MasterCard and other payment networks sell to consumers in separate services, which they sell to banks and other financial institutions that actually issue the cards to consumers.

The debit card market adopted in the merchants' case was again national and general purpose in scope, and again involved card services to merchants. And most pertinent to our discussion today encompassed the two principal kinds of point-of-sale debit cards, so-called off-line signature cards and on-line cards which are used with a personal identification number or PIN.

In the *United States* case against Visa/MasterCard, the Antitrust Division asserted and Judge Jones adopted two markets also for national general purpose credit and charge card services. These markets involved the services

that competing networks sell to banks; and a second market, which Judge Jones loosely defined as the market in which these networks all compete with each other, without the court clearly specifying the area of competition but presumed to be the way they compete for the business of consumers and for the business of banks and for the business of merchants as well.

Now, in the *United States* case, a debit card market was neither asserted nor adopted by the court. I think there may be some of you who were actually at that trial or witnessed part of that trial, and I certainly did, when during the bench trial Judge Jones would inquire about how all the testimony and other evidence affected debit. At that point, the adverse parties, united in interest, would all suddenly jump up simultaneously and declare that the case had nothing to do with debit, notwithstanding the fact that Visa and MasterCard had asserted a product market which included not only credit cards, charge cards, debit cards but also cash, checks and wampum as well.

Now, this unrealistically broad market was an artifact of Visa's old (but still revered by Visa and MasterCard) victory in the Eleventh Circuit case. The famous *Nabanco* case. And despite the parties' attempted avoidance of debit in the bench trial, Judge Jones extensively discussed debit cards in her original 2001 decision and extended her injunction to preclude debit card as well as credit card exclusivity in her judgment, despite the fact that the Judge did not adopt any market in which debit resides alone or with any other products.

In the *First Data/Concord* case, the third case we will be discussing today, the government plaintiffs asserted a narrow market defined as general purpose on-line PIN, personal identification number, debit card services. Excluding from the alleged market Visa and MasterCard off-line signature debit card services, services which accounted for more than 60% of debit card volume in the United States, 60% of the volume in the broader debit market adopted by Judge Gleeson in the merchants' case.

Significant criticism was leveled against the government's asserted narrow market definition in *First Data/Concord*, deemed by some as gerrymandered, including by my partner Jeff Shinder, who is here with me today, and as well by myself, which we explain in an article which you are getting as part of your materials for this panel.

This criticism of the putative narrow market intensified on the eve of trial when Wal-Mart, the nation's and world's largest merchant, armed with new untying rights that the merchants won in their case, announced that it would stop accepting MasterCard signature debit card transactions and simply ask their customers to use their PIN when proffering a debit card branded with MasterCard. This procedure should effectively and easily

convert what would have been a signature debit transaction to an on-line PIN debit transaction, in most cases a transaction offered by a competing debit network like NYCE or Star or Excel or Pulse or Interlink.

The eminent economists on this panel will talk about these market definition issues in the context of their overall economic analysis, and they will discuss, I hope, whether or not they believe that market definition is a particularly useful exercise in these cases at all, albeit a necessary chore given the state of the case law.

Those of you who have worked with economists in these cases know that market definition is boring; it is formulaic, and something that's imposed upon economists. Something they have to do because the case law requires them to do it. But we'll get the spin of these gentlemen on that.

These gentlemen will also address the so-called cellophane trap or fallacy, a term which emanates from the *Dupont* case and the criticism leveled at the *Dupont* court, which placed cellophane in a broader market with other comparably priced flexible wrapping materials, such as aluminum foil, seemingly failing to account for the fact that cellophane was comparably priced only because Dupont had exercised its monopoly power to the degree that cellophane was comparably priced with other flexible wrap. Anyway, in its classic formulation a court or litigant falls or willingly jumps into the cellophane trap by defining an overbroad market, because it fails to define a market using competitive prices.

In *First Data/Concord* some people, including Jeff and myself, have asserted that the government knowingly and strategically engaged in a new genre of cellophane fallacy by defining an economically incoherent market by again refusing to use competitive prices when defining the market and refusing to recognize that off-line signature was priced much higher than on-line PIN debit, only because of the exercise of market power by Visa and MasterCard. The government's complaint underlines this apparent error by explaining that both forms of debit were used for the same purpose, that on-line PIN debit is superior to signature debit in every dimension, including safety and speed, but signature debit is priced much higher. Think about that for a second. A whole list of characteristics in which on-line PIN is deemed by the plaintiffs, the government, the state AGs, the U.S. as being superior in every way, but off-line is priced higher. Why? Obvious answer: Exercise of market or monopoly power. And at the very moment that the government forced First Data and Concord to capitulate, Visa and MasterCard started the multi-year process of lowering signature debit prices both generally and through merchant-specific deals, narrowing the gap between signature debit and PIN debit prices. The panelists may, and I hope will, also address their view of Judge Gleeson and

Judge Jones' limited treatment of charge or T&E cards as either in the same market as credit cards or in a separate market unto itself. This issue is quite timely in view of cases recently filed against American Express, claiming that American Express is tying its revolving credit cards, such as the Blue Card, the Delta Airlines card and Optima card to its allegedly dominant T&E cards.

I will now introduce all of the panelists in the inverse order of their participation. First Jeff Shinder, my partner and a founding partner of our firm. Jeff is a graduate of Osgood Hall Law School in Toronto and received his trade regulations master's from NYU Law School. Jeff has taken a major role in many of our cases at the firm over the last decade. And most pertinent to today's panel worked with Frank Fisher and myself on the economic side of the merchants' case, a case which included the participation of Frank and Dennis Carlton for the merchants. Economists George Benston, Orly Ashenfelter, Ben Klein, John Danforth, Louis Mandell and Stewart Meyers for Visa and MasterCard, and Dick Schmalensee, incredibly, for both of them. Just think about that when you're trying to show that you really compete: you hire the same economist to represent you.

Now, Jeff is a very frequent lecturer and author on a variety of antitrust topics. You may have seen his article last week in the *Law Journal* about how the Microsoft decree failed its first test in the *Real Networks* issue.

The next panelist is Eric Emch. Eric is an economist with the Antitrust Division. He worked on both the U.S. case against Visa and MasterCard and the government's case against First Data/Concord. Eric received his A.B. from Brown and his Ph.D. from Berkeley and taught and conducted research at both Berkeley and the University of Chicago.

Eric has published frequently in the field. And closest to my heart and my wallet, Eric has published on the savings impact of college financial aid. He has won a host of awards, including the Brown Class of 1873 prize for Excellence in Economics, a class which predates the antitrust laws and modern economics, or so I believe.

Janusz Ordovery will speak next. One of the giants of industrial organization economics, I think known well and liked by all of us. He received his Ph.D. from Columbia and master's from Warsaw University in Poland. He taught economics at Yale, Columbia and at Harvard, but most consistently at NYU, for more than 20 years. He has authored or co-authored a bunch of books and a bushel of articles. He was the chief economist at the Antitrust Division. And recent tradition dictates he held the title of Deputy Assistant Attorney General, and held that job without the benefit of a law degree. But that's the current practice.

Janusz is the Director of Competition Policy Associates, an economic consulting firm. Most pertinent for today, Janusz was lead economist for the United States in the recent successful challenge to the First Data/Concord merger.

Lastly, Frank Fisher will speak. Frank is my hero—and actually, Frank will speak first—Frank is my hero in the field of antitrust economics. Among the scores of times that Frank has been lead economist for an antitrust litigant, let me mention three. Lead economist for IBM in *United States v. IBM*. He was lead economist for the United States in *U.S. v. Microsoft*. Frank was our lead economist and indeed the only economist testifying for the merchants on the merits of their recent case against Visa and MasterCard, going toe-to-toe with that long roster of eminent economists which I read before. Frank against that group is not a fair fight, and it showed in Judge Gleeson's decisions.

Frank got his A.B., his masters and his Ph.D. at Harvard. In an act of spectacular ingratitude, he has taught for most of his distinguished academic career in the 02138 zip code at MIT. He's taught at other zip codes as well, Chicago, Hebrew University in Tel Aviv and others. He is Director of Charles River Associates, author of 18 books and hundreds of articles, including one which he's trying to co-author with me, if only I would cooperate. Since Frank is pander proof—that's not panda proof—Frank is no less fond of pandas than anybody else, he likes Ling-Ling and Shing Shing as much as anybody else. Frank is pander proof. So that anecdote did not get me off the hook to do the article. I screwed up the order. So the order of speech will be Frank, then Janusz, then Eric, then Jeff, and I will try to make some trouble. Okay.

DR. FISHER: Well, Lloyd and I agree about most things, and I agree about most of his introduction to me. But I only count 16 books. You've got to go back and look at it.

Anyhow, as Lloyd has suggested, economists don't like much talking about market definition. Some economists don't, and I am principal among them. It is not just boring, it is wrong. Market definition — and by the way, I don't like coming to conferences and talking about market definition either. Not because it's wrong, but because it is boring. I don't like it when lawyers call up and say, well, we want you to testify about what the market is in this litigation we are bringing. I like it still less when they tell me what the market is and then say to me, we want you to testify.

But these cases do have some interesting sort of market definition issues, and it gives me the opportunity to explain why market definition is not a really good way of getting at nearly anything in these cases. So I'm going to talk mostly about the merchants' case. And I'm not

going to talk about the government case against Visa and MasterCard. But I will talk a little bit about the *First Data/Concord* case, and I am going to talk about cellophane. I guess I'll talk about cellophane first and again last when I get to *First Data/Concord*.

Just to remind you, and Lloyd has already done this, the Supreme Court decided the cellophane case in the '50s by putting cellophane and flexible wrapping papers in the same market because there was evidence that people chose among them. They were then roundly criticized by, among others, a whole bunch of economists who said that's not right. It is true that at the existing prices people substitute between cellophane and other flexible wrapping papers. But the fact is that at lower prices, which would be profitable to DuPont, the maker of cellophane, there wouldn't be such substitution. All you're saying is that DuPont has raised the price up to where those other things begin to compete. And they went on to say, therefore, you ought to argue that flexible wrapping papers that are not transparent are not in the same market. Well, I think they were wrong too, actually. Although I do think the case was wrongly decided.

By the way, in case I forget to say this when I get to the *First Data/Concord* matter, I'm only going to talk about the market definition. I do not have an opinion as to what the right outcome should have been for the merger on that.

Now, why do I say that I think the critics were wrong too? And it illustrates one of the things that's wrong with market definition. Here are the facts. At certain high prices, cellophane and flexible wrapping papers in general competed. At lower prices for cellophane, which would still be profitable for the maker of cellophane, they didn't. Once you've said that, you've said everything you need to know about what's going on here. To try to cram that into the statement they are in the same market, or they are not in the same market is just going to suppress the information. You're not going to get anywhere after that. What you should say is okay, here are the prices in which one thing happens; here are the prices in which the other thing happens. Now what does that tell us about power and competition from flexible wrapping papers? And that in general is what I think about market definition. It is a good way to get started, but you have to be very careful not to be so fascinated by market definition that it suppresses all the information as to what's going on.

I am now going to turn to the merchants' case in which I hope to illustrate that, while you can do market definition in the merchants' case—and of course given the status of judicial opinions, you have to do market definition in cases—although you can do it, it is not particularly useful. You can do very well without ever doing that at all.

Now let me be sure we all understand what the merchants' case was about. Lloyd has at least outlined it. In the first place, this was not a case about competition for banks, except indirectly. It is not a case about competition for cardholders, except also indirectly. It was a case about services provided to merchants.

When you go in to a merchant and you pay with your credit card, as you are presumably aware, the merchant does not receive the full amount that you pay. The merchant receives that minus something called the merchant fee, of which the principal component is something called the interchange fee. The interchange fee is something that is a piece of the merchant fee—a large piece, that eventually goes to the bank that issued you the credit card in the first place.

Now, in credit cards, the interchange fee is pretty high. And merchants put up with it and have for many years because they really want the sales that accepting the credit card brings in. Many of these are known as incremental sales. As they are sales that the merchant would not make if they didn't accept the credit cards. Why? Because the cardholders, when they pay with a credit card, sometimes do it as a matter of convenience, but very often are doing it by borrowing money. They are paying with other people's money, and they are making purchases they couldn't afford to make if they were limited to the size of their own bank account. And merchants make money by making those extra fees. There is also a justification interchange fee of sorts in terms of the risk of extending the credit. But that's not my main focus.

Now, there are also debit cards. Debit cards at first basically were ATM cards extended to being used at the point of sale. And Visa and MasterCard also got into the business very early, and gradually these two things came together in some sense.

There are two kinds of debit transactions. By now almost all cards will do both. Any Visa, MasterCard or debit card usually will do on-line transactions as well. When you pay in a Visa or MasterCard transaction, the debit card acts the same as far as you're concerned, the same way a credit card does, at the point of sale that is. You sign, the transaction is verified, and the money comes directly out of your bank account. The merchant gets paid a few days later. The other way to do it is, you swipe your card through a PIN reader and you enter your personal identification number and then, usually, the card will act as an on-line transaction and won't go over the Visa and MasterCard system. It will go over something like NYCE or STAR or MAC and so forth. On-line, by the way, is much faster, much more reliable, basically a much better system.

Now, what Visa and MasterCard did was to apply something called the Honor All Cards rule to the rela-

tionship between debit and credit. And the Honor All Cards rule—I'll do this for Visa, a similar thing is true for MasterCard, so there is no point in repeating it. The Visa Honor All Cards rule said anyone who accepts a Visa card has to accept all Visa cards. And in particular that meant that if you accepted Visa credit cards, you're now a merchant, you've changed personalities; you're no longer a customer. If you are a merchant and accept Visa credit cards, you must also accept Visa debit cards. And having done that, they basically forced merchants to accept Visa debit cards. Why? Because as I pointed out, merchants really, really want to accept the Visa credit cards. Giving that up is very expensive to them. So they accepted Visa debit cards, and they discovered they were paying essentially the same rate of interchange on the debit cards that they were on the credit cards.

Apart from the fact that the risk on debit was much less, debit cards don't bring in incremental sales of any magnitude. That's because the debit card is just another way of accessing your own bank account (I'm sorry, you're the customer again) and there are lots of ways to do that: pay by check, or withdraw money from an ATM and pay cash. But debit cards don't give you extra money to play with. Although it is a convenience, it is a convenience to the merchant as well. And merchants indeed protested against the high interchange fees, but they were stuck. Now I don't want you to think that I considered this A Good Thing or an admirable thing, but it was really clever. What Visa and MasterCard did was succeed in perverting the workings of the price system. What they did was charge a high price for something, and the merchant who got charged the high price was not the person who chose whether or not to buy, as it were. The thing being bought was going to be bought. It was the cardholder who chose how the transaction went, and the merchant could not refuse. Visa and MasterCard thereby gained substantial power over price in debit cards.

Now, there were some other things as well. In order to make this really stick, it turned out to be a good idea to help keep the merchants from knowing whether they were dealing with a debit card, so they couldn't even try to break the rule or steer the customer. And Visa and MasterCard encouraged their banks in fact to produce cards such that you can't tell very easily whether they are credit or debit cards. In many cases they look essentially the same, and you really have to know what to look for to distinguish them. They have even fooled my wife, which by the way is not an easy thing to do. And they also fooled merchants.

Now, what does market definition have to do with all that? Doesn't have much to do with that at all. I just described a story which is blatantly anti-competitive. And I've done it without talking about what the market definition is. I'm now about to describe a set of market

definitions that fits the facts. But my point here about market definition is that's sort of unessential in this case. What would the appropriate market definitions be? Well, one way—and there are several ways to do this. One way is to say there is a market called credit card transactions for merchants. Debit transactions are not in the same market. Why not? I already told you why not. Because credit card transactions are a different product; they bring in incremental sales, and debit cards do not. So that merchants perfectly reasonably might not want to have the debit cards and do want to accept the credit cards.

Is American Express in that market? Why do you care, so to speak? Now, in fact if you start calculating market shares of credit, you will discover that Visa has an enormous share, and MasterCard has a somewhat smaller one. And if you include AMEX, those shares go down, but they don't go down a whole lot. I'll get back to AMEX.

But you could also do this differently. Surprisingly, you could define Visa—the acceptance, the provision of Visa credit card services to merchants—as a market all by itself. Why? Well, if Visa charges a high price, and it does for that, can merchants refuse it in favor of substituting MasterCard? The answer is no. There are lots of people who carry Visa and don't carry MasterCard, and those people will bring in incremental sales. Merchants can't really afford to do that. And anyway, merchants can't accept more MasterCards than before. The same merchants are typically accepting all the MasterCards that are brought to them.

If you want to go further, you could in fact define MasterCard as being in a market all by itself, for the same reason. There isn't any real competition between Visa and MasterCard for merchants. It is partly because of the way Visa and MasterCard operated, that is true. But even so, it is not possible for merchants to substitute the acceptance of Visa for the acceptance of MasterCard. It doesn't bring in the same sales. And if you did that, you would conclude that yes, either you can conclude by defining them together, that they both have substantial market power in the market for general purpose credit card services to merchants, or you could say actually, they both each have monopoly power in their own particular place. It doesn't really matter. You're going to get to the same place, which is: Could they force the merchants to accept the debit cards? That's what this is really about. And the answer, is well of course, they could. And they did. And they both obtained substantial power over price, as I said before.

I don't care whether you call that monopoly power or substantial market power. Since it lasted for a long time and it was substantial, you can claim it was, at least jointly, monopoly power. Now to make that in fact stick, Visa and MasterCard, particularly Visa, actually

embarked on a campaign to destroy the on-line networks. And I'm not going to go into the details of that campaign, but one of the things they did with that is that they tried hard and succeeded in forcing the on-line networks to raise their interchange fees. On-line networks had traditionally had interchange fees at approximately zero. Until this repeated campaign came along and under pressure of various sorts—the details don't matter—from Visa and MasterCard. They raised their prices, and they got away with raising their prices—this is the important point for what I want to say later. They got away with raising their prices, because merchants contemplating the question of whether to refuse on-line debit cards had to realize that the alternative, since people want to use debit, the alternative is going to be to accept, to have more Visa and MasterCard debit transactions, and that's going to be at an even higher price. Of course, when they raised their price, the on-line networks were contributing to their own potential demise, because that reduced the long-term incentive to invest in PIN pads, if merchants didn't already have them, and that retarded their growth. But that's what was going on here, and that's why the prices have been high.

Now comes the settlement in the case, and the Honor All Cards rule is gone and Wal-Mart is starting to refuse MasterCard. Now, what one expects to happen is there is now going to be competition, and competition between off-line and on-line. There won't be an umbrella over the price of on-line, and on-line prices will presumably come down, as off-line prices have and certainly will continue to do so. How fast, of course, one doesn't know.

Now, this brings me to the cellophane case, and also to the market definition in *First Data/Concord*. I already said what I thought about the settlement case, and it seems to me that the definition of on-line PIN debit as services to merchants as a separate market essentially commits the same error. One way to say it is as Lloyd said it, it doesn't look at what would happen in competitive prices. But, to put it another way, it just overlooks the facts of what's been going on: namely, that the high prices for on-line PIN debit could occur because the prices for off-line debit were even higher and because merchants were being forced to accept off-line credit.

In the world without that, and the world I certainly hope and I also believe will emerge as a result of the settlement in the merchants' case, that's not going to be true. And one will have to take account of the fact that off-line debit will have to compete with on-line debit. And once you've said that, I don't care whether you now say off-line is in the same market as on-line, but I do care whether you ignore that by producing a market definition and market shares that only concentrate on on-line.

As I said earlier, I'm not making a statement as to whether I think the merger was a good merger or a bad

merger for antitrust purposes. I'm only talking about it for purposes of talking about market definition, which I wish I didn't have to talk about at all.

MR. CONSTANTINE: Thank you, Frank. Okay, now Janusz will speak.

DR. ORDOVER: Takes one's breath away to listen to all this. There is so much profound thinking and so much wrong thinking in twenty minutes that I don't know where to start. But Frank is Frank, and I'm just a simple Polish immigrant. I don't know my credit card from my hologram.

What I want to talk about is—well, there is a bunch of things I want to talk about. First of all, market definition. I agree with Frank, obviously; how can I not? That market definition is neither the end-all or be-all of antitrust analysis, and it is obviously a distraction. And so it is a distraction because it is kind of a very programmatic approach to calculating shares. And then one tries to make inferences out of wrongly calculated shares in a misdefined market and that really doesn't mean anything to anything.

However, the Merger Guidelines, which is what we are required to follow in the *First Data* case, do require that at least one makes a stab at understanding what the relevant market definition is. The reason I view that to be a wise place to start is, again not because that will help me answer whether or not a particular transaction is or is not anti-competitive, but primarily because by thinking about market definition, at least through the lens that has been developed under the Merger Guidelines over the past 20 years or really maybe 10 years, since the 1992 Guidelines came out, helps you organize thinking about the issues that Frank so beautifully pitched to you. Which is to say: What are the competitive constraints that operate in this market on the firms that we are analyzing? What are the competitive constraints that prevent those firms from elevating price post-transaction, enabling them to potentially better coordinate their activities after the transaction? There are the activities of the two merging firms and potentially all the other ones with which they compete. What will consumers do in the event of such behavior that, as I discussed in the morning session, is to the detriment of consumers? So the market definition step is really there to make you want to sit down and start thinking about competitive constraints. It's not there to think about anything other than that. And I believe that the lens that has been developed, the so-called SSNIP test or hypothetical monopolist test, is in fact a useful way of organizing and thinking about these kind of issues. Of course, one can fall into the cellophane fallacy trap and get yourself wrapped up in flexible wrapping and covered in tin foil at the end of the day, and you don't know whether you're coming or going or what's going on. But I think—whatever it is, 50 years since the cellophane trap, people

who actually do these things try to avoid such mistakes. And I can assure you that during the discussions regarding the market definition step, as I described it in the *First Data* case, we did spend a great deal of time thinking about prices of alternative products that consumers use to effectuate transactions. Those could be credit cards, charge cards and even this thing called—wampum?

MR. CONSTANTINE: Wampum.

DR. ORDOVER: In Poland we have zlotis, so maybe we can use zlotis.

Anyway, the point I'm making is that, of course, everyone who was sitting on this meeting was fully aware of the fact that there was the settlement; that there were required price reductions to merchants by MasterCard and Visa which actually reduced the interchange or the merchant fee discount by about 40%. I think it's around 40%, a tremendous discount relative to what it was when the Honor All Cards rule was in place.

Now, the question then still arises whether or not that kind of price reduction is sufficient to abandon the proposition, which is the one that we are analyzing, and that is whether or not the combination of the number one and number three PIN debit networks would have some anti-competitive effect on some well-defined group of customers, and the group of customers we focused on were the merchants.

We did try to ask that question by taking into account as well not the old prices for signature debit but in fact the new prices. And in fact, up until this very moment we have tried to figure out exactly what were going to be the new releases of the merchant or the interchange that MasterCard and Visa in fact were going to post.

So I have to take pride in the Division. I was there for a while, and I was partly responsible, following my esteemed colleague Professor Willig in bringing the Guidelines to fruition. So I was fully aware the language in the Guidelines says the Guidelines will define the relevant market, that is will capture the existing constraints on the merging parties' ability to increase prices, deteriorate quality, do whatever it is that's adverse to consumers, taking into account the proper price level from which to start the analysis. In general, the Guidelines say we will look at current prices, but when current prices are not the proper benchmark, the Guidelines say look at something different, maybe the competitive level.

Now, notice that we are not talking about here the competitive level of cellophane and trying to figure out whether cellophane is or is not in the market with other flexible wrappings, like aluminum foil or butcher paper. We are worrying about the price of a potential substitute product which was the signature debit, okay. So this is

cellophane slightly wrinkled in the sense that it is not the price of PIN debit that was elevated; it was the price of a potential substitute which did indeed make PIN debit a very attractive alternative to merchants. And I think indeed it is the case, although the parties tend to dispute it, that on many dimensions of relevance the PIN debit product was in fact a superior one. The PIN debit being the on-line debit, PIN, on-line, same thing, okay.

So we have the Guidelines which say take the current prices as relevant unless some other prices better reflect the forward looking competitive realities. Not forward-looking price for PIN, but forward-looking price for here the signature was the issue. And the way we resolved it, and I should say while it is true that the prices have narrowed in part because, as Frank described, both MasterCard and Visa undertook a very effective campaign of raising the interchange for PIN debit, nevertheless we were of the view that the gap was still there. It was still substantial, and in fact was of such magnitude, given the superior quality from the merchant standpoint and also from some consumer standpoint of PIN debit, that increasing the price of PIN debit to merchants could have been sustained by a hypothetical monopolist. And that walks me into what I consider to be the most challenging issue in this whole deal. And that is: Exactly what price is it that we are supposed to be looking at when we are performing this hypothetical monopolist or lovingly called SSNIP test?

What price? There was a great deal of confusion perhaps due to some bad articulation of the issues by me. I'm perfectly happy to take criticisms when they are warranted.

The issue was this. Look, the merchants pay a merchant discount fee which is comprised of two things. And if I can find the slide, I will show you. On this slide you see what it is that we are talking about. The merchants are paying all kinds of fees, only two of them were actually of interest to us, which is the merchant discount fee, and that's a sum of two components, the interchange, which is what the merchant acquirer pays to the bank that issued the card that's used in the transaction, and then something called a switch fee, merchant switch fee. The network that runs the transaction does not collect any profits out of the interchange. The interchange just passes through. The only source of the revenue is the switch fee. So now you can see why we are asking ourselves as to the effects of this particular transaction. Was that transaction going to enable the two parties to raise the switch fee? And in order to answer that question we asked ourselves: What will the merchants do if the merchant discount fee went up to them, to the merchants?

So now you can see the problem. And if you see the problem, you're not the only ones. The judge had a bit of a problem with that as well, by saying, if you are a net-

work, why would you increase the interchange, which you don't collect? And the reason I advocated focusing on was the total merchant fee, because from the merchant standpoint it really does not make any difference whether out of the 25 cents on, say, a hundred-dollar transaction that the merchant pays, five goes to the network and 20 goes to the credit card-issuing bank or 20 cents goes to the network and five cents goes to the issuing bank. This is somewhat crude and an approximation. It potentially does make a difference, and we can talk about it later on. But I'm probably already running out of time. So as you can see, our issue here was focused on this particular circle that I have up there. And that is the merchants' transactions were with the networks.

Question: What would merchants do in the event of an increase in the merchant discount fee? What would they do? Would they switch to signature debits? Would they decide to discontinue PIN debit? Would they engage in a strategy called steering, which is when you come in and you try to use your PIN debit card, they would say no, no, no, cash only. Or they would say please use signature debit, or why don't you put it on your charge card, or something of that sort. There is a lot of activities that the merchants play that you may not even be aware of that try to guide you to perform the transaction using the technology that is the best from the merchant standpoint, the cheapest one. Sometimes it is very visible, sometimes less so, but merchants do that all the time. Banks do that as well. Banks will try to reward you for using signature debit as opposed to PIN debit. Why? Because the interchange that the banks collect on signature is much higher than what they collect on PIN.

So on both sides of that network you have players and also consumers whose decisions are all in some sense uncoordinated. Merchants would like to get the cheapest means of payment. The consumers choose the one most convenient or the one most rewarding. I always use American Express card for a variety of reasons. Other people will use Visa, MasterCard; whatever people do, they do. A lot of people still use checks. Some use cash. In France they all use debit card, because it is very hard to have a credit card in France. In any case, the point I'm making is we have various players, and these players' decisions are all individually motivated and in a way that does not necessarily induce the maximum efficiency overall. Which is why my opponents, and one of whom is distinguished colleague Frank Fisher—always MIT fighting. Fisher, Hausman, they all seem to be taking different positions on different sides. No MIT school of antitrust economics, which I think is a good thing, because that creates profound thinking and a great deal of diversity.

What Michael Katz and Jerry Hausman were saying, look, this is the kind of market which is different from proverbial widgets or even cellophane. In that market a

consumer walks into the store, the consumer says should I buy cellophane or should I buy butcher paper? And he can see what's up there, and he can buy one or the other. Here we have markets that are spanned by these networks, the decision makers, each of them following their own individualistic objectives. Absent some kind of coordination, this whole market will not function.

These kinds of markets people refer to as two-sided markets. Because two sides of that market have to come together in some coordinated fashion for a transaction to take place and economic surplus being generated. And what was being put forth as a challenge to the economics community and to the legal community, something that we haven't talked about yet, that is whether or not the Merger Guidelines and the standard market definition approach, assuming that you have to do some of that, can be actually undertaken in these types of two-sided markets. And there are plenty of these kinds of two-sided markets in the economy. And I don't want to bore you with that, but many markets require coordination of more than just a buyer and a seller, but in fact there are intermediaries in between who has to span the market in ways that make all of this possible.

So my favorite example I always teach in my industrialization economics class is the bartenders who sometimes offer free drinks to some people in order to stimulate the network activity in the bar, which generally is conducive to substantial alcohol consumption. Although now perhaps not as much as before due to the nonsmoking rules, thanks to your mayor. I live in Connecticut.

Anyway, the point I'm making here is that—Michael Katz and Jerry Hausman—the standard tools, irrespective whether you want to apply them or not, could not be applied to two-sided markets. I could not see for the life of me why not. That was one of those dictums that Supreme Court judges are prone to issue. Anyway, there was the dictum. So why not? Why is it why not? I can try to fill in the holes, but the basic proposition I want to put forth is that, in fact, in this particular case we have examined, despite this being a two-sided market, a standard approach was in fact applicable. Why? Because our focus was on just one component of the fee to the merchants, which is the merchants' switch fee. And that was the component of what the merchants were paying that the networks that were merging would try to maximize, multiply the volume of the transaction so they want to look at price, volume and figure out the right way to go. And that's what the question was, whether that element was going to go up to the merchants or not. And that we believed could have been answered first by asking ourselves whether or not merchants would simply bolt, resist, do something that would make it impossible for such an increase to be implemented. And I believe that looking at the market definition is a useful thing in that regard.

In any case, to sum up, I do believe that the cellophane fallacy is potentially an issue. I can assure you that when we thought about the issues in the *First Data* case, we were aware of the settlement. We were very well aware of the fact that signature prices were falling. We were aware of the fact that the markets were two-sided, so they required complex coordinations by various groups of players, economic actors. And we also were very much interested in a very simple question, which is to say: Would a hypothetical monopolist be able to raise a component of what the merchants are paying if it had that kind of hypothetical guideline given market or monopoly power? And I believe that we reached the correct conclusions on a variety of issues, of course we could have been totally wrong if the next day after the settlement Visa decided to slash its prices by an additional 40%. So there was complete parity as between PIN debit and signature debit, and in such an environment perhaps—perhaps an increase would be impossible to implement in terms of unilateral conduct or maybe even coordinated conduct.

So I want to leave you with that. Hopefully we will have some time to discuss it after opposing views from other people on the panel. Thank you very much.

MR. CONSTANTINE: That was great, Janusz.

Eric Emch now please.

DR. EMCH: I think Janusz has done a very good job of defending the government's honor in *U.S. v. First Data/Concord*, so I'm not going over that territory.

I'm going to talk more about the big picture, having worked on both *U.S. v. Visa/MasterCard* a few years ago, and more recently as one of several internal economists working on *U.S. v. First Data/Concord*. I've noticed a lot of these issues that come up in the payments industry with market definition come up again and again in the same form, and a lot of it has to do not so much with the theory of the hypothetical monopolist test and market definition, according to the Guidelines, but how as a practical matter do you implement it in each case. Because the payments industry introduces a number of complications to the hypothetical monopolist test that weren't really anticipated when the Guidelines were written or at least were not included in the written version of the Guidelines.

So I'll talk about some of the big picture, some of the differences between *First Data/Concord*, *U.S. v. Visa/MasterCard* and the *Wal-Mart* case, to the extent I know something about that.

First of all, I always have to put up this slide. This is not the official Department of Justice view. And if someone takes it as that, you know, I could get in big trouble, so please don't.

As I said, this is somewhat more complicated. The implementation of this hypothetical monopolist test is more complicated in payment systems than in some other industries. Why is that? I'll go through a few reasons here.

First of all, there is the question that comes up in any market definition exercise: What products do we include? That's an issue here, as it is in any traditional industry that we look at. But that's only one of three dimensions that are important here. The second dimension is: What buyers and sellers are we looking at? I mean in payment systems we have network selling services to banks, banks selling services to consumers, networks selling services to merchants, banks selling services to merchants. Where are we looking when we are applying this hypothetical monopolist test? And the third dimension, the hypothetical monopolist test in payment systems is: What prices should we adjust? I mean the Merger Guidelines tell us we should assume a hypothetical monopolist and consider what happens if that hypothetical monopolist raises prices 5-10%. What prices are we talking about? And it seems again, in a lot of markets we look at it, it is a very straightforward question and answer. But in payment systems it is not so straightforward. Janusz touched on this somewhat in the *First Data/Concord* case, and I'll talk a little bit how that came in up in *U.S. v. Visa/MasterCard* also.

And finally, something else that Janusz also touched on is the two-sidedness of the market. One argument made in recent years goes something like this: Payment systems are a two-sided market. Two-sided markets are complicated. Therefore, the traditional hypothetical monopolist test does not apply. I think that's clearly wrong. The way in which you implement a hypothetical monopolist test may be slightly different in two-sided markets than in other markets, but you shouldn't throw up your hands and abandon the exercise entirely. And I have not heard any good argument as to what would be a better way to do a market definition exercise in a two-sided market, except for some form of the hypothetical monopolist test, as long as you keep these two sides of the market in mind. When I get to that part of the presentation later, I'll talk about how you would keep these two sides of the market in mind while doing your hypothetical monopolist test.

So I just wanted to start out with a review of what's been talked about so far. But there are many different products that we talk about, and when we talk about payment systems, many different products that have come up in all these three cases.

This is just kind of a schematic to show a few dimensions of differentiation. The size of the circles is the share of personal consumption expenditures in 2001 made up of that payment type. So as you can see, actually it is surprising that checks are still a huge part of the econo-

my and bigger by itself than any single other payment system.

Now, I've drawn two dimensions of differentiation here, acceptances and deferred payment. These products differ on many dimensions. I picked these two, because they are two that we talk about a lot. But you could draw other dimensions of differentiation, such as length of time it takes you to use the product to check out, such as the fraud costs for the given payment type. But if you look on these two dimensions you see on the far end is cash—which is universally accepted, but has no deferred payment mechanism—and on the far opposite side of the schematic you have proprietary credit cards—which are single store credit cards, like Sears store or Macy's cards, which have very limited acceptance at one or more stores possibly, but at very high deferred payment because it is, after all, a credit card.

Now, PIN debit, checks and signature debit all have some deferred payment mechanism in that payment is not immediate. When you write a check it is actually not deducted from your account until maybe a few days or week later. PIN debit and signature debit are more immediate but not completely immediate and take anywhere from one to three days to complete the transaction. PIN debit in that dimension is faster than signature debit generally.

Now this gives you an idea of the broad payment types we are talking about. I'll draw some of the relevant markets that have been drawn for these different cases. In *U.S. v. Visa/MasterCard* and the *Wal-Mart* case, the defendants were saying that all forms of payment are in a single product market, and this is what Lloyd and Janusz were talking about, wampum, anything you could think of to effect a transaction between two people must be a part of this product market. And of course, we all thought this was very broad, overly broad, and the Judge in both of these cases did not agree with such an overly broad market.

In both *U.S. v. Visa/MasterCard* and the *Wal-Mart* case, we drew a product market that included credit and charge cards, although I understand in that case they also drew one that just included credit cards. Whether or not you include charge cards with credit cards wouldn't have affected the outcome or analysis in any of those two cases I think. It affects what market shares you come up with, but it doesn't affect the bottom line very much. I think you could make arguments either way. This has not been such a bone of contention that either side has spent a lot of intellectual effort on it.

In the *Wal-Mart* case they drew this debit market that included both PIN and signature debit. They called it a POS debit market. And as has been discussed at length in *U.S. v. First Data/Concord* we drew a PIN debit consisting of just PIN debit, not signature debit, for the reasons Janusz explained.

So this is one dimension of the analysis, and with most products it stops there. I have decided that aluminum is in a separate market from tin, or I've decided cellophane is in a separate market from other wrapable plastics, then the price or level of commerce automatically falls out of that. It doesn't so much in payment cards, and I'll talk about some of the different ways that we looked at this in *U.S. v. Visa/MasterCard* and in the *First Data/Concord* case.

Now, in *U.S. v. Visa/MasterCard* we had two levels of commerce that we looked at within credit cards. The first was something we called general purpose card network services, and these are the services such as the payments infrastructure, the acceptance network, branding, advertising, that card networks such as Visa/MasterCard and outside of the U.S., American Express, offer to card-issuing banks. And you know, as Lloyd mentioned, within the U.S. it won't be too long before American Express and Discover are offering these services to banks.

The second market we looked at within credit cards was what we call general purpose card services, and we looked at a hypothetical monopolist test involving hypothetical merger of card-issuing banks and the prices they charged individual cardholders. So in this market we are talking about services that banks offer to cardholders. These include the payment card itself, the credit line, customer service features, insurance, rewards programs, cash back, things like that. Very different set of services from this general purpose card network services and yet they are both sort of in this product market or this product of credit cards.

Note that there was no market in *U.S. v. Visa/MasterCard* that consisted of services offered to merchants. This was a difference between our case and the *Wal-Mart* case and the *First Data/Concord* case. We did not assert this market to merchants at all. And, you know, why is that? Well, your market definition depends on the theory of harm you're alleging, where you think the harm is going to occur in your case. In *U.S. v. Visa/MasterCard* we were concerned about network competition being inhibited between Visa, MasterCard, American Express and Discover. These networks are competing for the services of card-issuing banks. That competition was prohibited by Visa/MasterCard rules, so it was very important to consider whether card-issuing banks could substitute other services or their own services for these network services to determine whether harm would flow. And if either banks had close substitutes for card network services or consumers had close substitutes for credit cards, it would have been hard to make the argument as we did, that this network restriction would harm competition and that harm in competition would flow through to consumers. You know, if consumers could easily substitute—if they didn't care if they used a credit, charge, debit, cash or checks—it would have been very hard to

assert that they were actually being harmed by these practices.

In *U.S. v. First Data/Concord* we did look at a merchant market because we saw the harm was actually going to flow mainly through the merchants. So we defined a market of card networks offering services to merchants, and these card networks were these PIN debit card networks, such as Star, NYCE, Interlink and companies like that.

So I've talked about product and level of commerce. Now I'll talk about the relevant prices. And you'll recognize this slide; this is actually property of the United States Government slide on loan to Janusz. This is just a quick schematic of relevant prices in payment cards. And actually, it is interesting that this single schematic fits both PIN and signature debit and credit cards pretty much the same way. I mean there are some nuanced differences, but you can talk about the three within this diagram. So you see money flowing from merchants to issuers to processors to networks from acquirers to networks, issuers to networks. And consumers are sort of a back-and-forth with issuers. They are receiving some cash back loyalty. They are giving up interest payments, maybe an annual fee and some sort of usage fee perhaps. Now, notice there are no payments here between consumers and merchants for payment cards, and that's something when you're thinking about this market in theory you might think that, well, one way merchants could use to recover the costs of say signature debit, which is maybe a product they wouldn't want to take otherwise and is expensive for them, maybe they could charge consumers to use the signature debit product or charge a consumer for using credit cards in general, since credit cards are much more expensive for the merchant than cash is generally.

It has generally been true in the past that Visa/MasterCard rules have limited the ability of merchants to surcharge consumers for the method of payment. They have traditionally allowed what's known as a cash discount. I mean, which is effectively a surcharge for credit cards, but you have to call it a cash discount. If you remember five years, ten years ago, a lot of gas stations would offer discounts for use of cash, and some still do. You talk to merchants, and a lot of them really don't like differentiating between the payment types, regardless of Visa/MasterCard rules, because they feel like they don't want to be charging someone for paying them. That's the way they explain it. Depending on consumer preferences, how consumers react to these prices, you might actually think that makes some sense.

Now, again, in *U.S. v. Visa/MasterCard*, in this network services market, we focused on the prices that issuers pay to card networks for these network services. And the government's expert, Michael Katz, considered

hypothetical monopolist card networks: Would they be able to raise prices to issuers by 5-10%? He argued and the court agreed that the banks' issuance behavior would change barely at all for a 5-10% price increase in the network services they pay, in part because that's such a small component of their overall costs, and the profits made on credit cards far outweigh the small component of their cost. So Michael Katz argued that we should look at this hypothetical monopolist test here, look at an increase in these prices; the judge agreed, and that's how we came up with this network services market.

Now in this downstream market of services offered by banks to issuers you've got a couple conceptual problems. One is that every consumer pays a different price, and some of them are actually paying negative prices. If you have a consumer who is not carrying a balance, has a credit card with no annual fee, and is getting some sort of loyalty program, they are actually gaining money every time they use the card. It would be a negative price. Even if they don't get a loyalty program, they are getting a 30-day float; that's worth something to the consumer. So what do you do with the fact that some consumers face a negative price, some face a zero price and some consumers who carry a balance, which is actually the majority of them with credit cards, actually are paying a fee for every time they use the card?

Now, the court and Michael Katz both agreed that this introduces some conceptual problems but does not invalidate the SSNIP test or the hypothetical monopolist test exercise. Professor Katz did what is called a critical loss test, which is: For a 5% price rise, let's figure out and calculate how much of a loss in volume would there have to be for this 5% price rise to be unprofitable. And the critical loss number that he came up with was 16%. So there would have to be a 16% drop in a credit card volume for a 5% price increase to be unprofitable.

Various pieces of evidence suggested that that wasn't going to happen. The court agreed that that wasn't going to happen. And that's how we ended up with this downstream market.

Now one might think a key piece of evidence to bring to bear on this question is some sort of survey of consumers; call up consumers or contact them in some other way and ask them, would your use of credit cards change for this price rise. Actually, there are some conceptual problems with that. Because for one, we know every consumer is facing a different set of prices. We would have to know every consumer's balance, interest rate they are paying, rewards programs to know the price that that consumer faces. So to figure out that price and then apply a 5% price rise to it—it is difficult conceptually to figure out how you would do it. And both our economist and one of the economists on the other side agreed that you couldn't do this kind of survey.

Another economist on the other side did attempt to do such a survey. What he did was ask the consumers if the price of what you're buying, say a book, goes up by 5%, would you switch to another form of payment? And what he found was there is a lot of substitution there if the price of the book goes up by 5%. That exercise, while it's more tangible than this kind of vague price they face for using their payment card, is the wrong test to apply. Because when you're applying a 5% price rise on say a \$40 book you're talking about a \$2 increase, and Professor Katz calculated a typical consumer with maybe a \$40 purchase who is carrying a balance who would have to end up paying a month's worth of interest on this purchase, would pay maybe 50 cents for the use of their credit card. So a \$2 increase is a 400% price rise, not 5% price rise.

Ultimately the Judge ignored all the survey evidence. We argued that, to the extent the survey showed anything, it showed our market definition. The Judge didn't take a side but ignored the survey and said I like the way Professor Katz looked at this. A 5% price rise would have to cause a 16% drop in volume, and I don't think that's going to happen for various reasons.

The issue in *First Data/Concord* was: Do we focus on the total price paid to merchants, which includes interchange and network fees and assessments, or do we focus on the switch fee? And the correct way to look at it is focusing on the switch fee, and that's what we did. That one didn't go to court, but I think we were actually looking at that the right way.

So I talked a little about the two-sided nature of the market and what might affect the analysis. How do you define a two-sided market? One definition that's been thrown around by economists is that it is a market where you've got one firm selling two complementary products and there are network effects across the two groups of consumers. So in payment cards you have networks selling services to banks and to merchants. The merchant demand depends on how many banks use the product, and the bank demand depends on how many merchants use the product. So there is a cross market network effect. Some other examples, aside from payment cards, are video game platforms; Sega or Sony decides what price they are going to charge developers to develop games for their platform, what license fee they are going to charge and what price they are going to charge for their platforms for consumers to use.

How does this price affect the hypothetical monopolist test? Well, considering a hypothetical increase on one side of the market, considering networks increasing prices to merchants, that if that has some impact on merchant demand, it might be the case that merchant demand itself isn't enough. They won't have enough impact on merchant demand to make it unprofitable. But

that will feed through to issuer demand. So we have to think about the feedback through issuer demand and whether that is going to make it unprofitable. This is a question we were all very aware of in *U.S. v. First Data/Concord* and considered these effects on the different sides of the markets. If there is going to be an effect on merchants, is that going to feed back to issuers in any way?

Finally, working for the government, there are Merger Guidelines. Our market delineation exercise that we like to use has come under some criticism here and elsewhere, and certainly economists are correct to point out that it is a very crude tool, and in some cases it is less useful than others. In some cases it is much less useful than others. What are some arguments for it? An economist looking at the effect of Visa/MasterCard Rule 210(e) or the Honor All Cards rule probably wouldn't be inclined to start by drawing market boundaries and looking at hypothetical monopolist price increases. They would develop a theory of harm and try to develop evidence that supported all the factual predicates of this theory of harm, and somewhere along the line the question of substitution of different products would come up. But an economist probably wouldn't think of doing the sort of formal market delineation exercise the way it is prescribed in the Guidelines. In fact, if you could show convincingly from your theory of harm and evidence supporting your theory of harm that this bad act, whatever it is, is going to lead to some bad outcome, the relevant market exercise is kind of superfluous. If you're convinced of that, then there must be a relevant market somewhere.

There are some things to be said for the market delineation exercise, which is not perfect, but I would argue is better than the alternative of chucking the whole thing, although maybe not as good as some alternatives that one could think of that aren't quite yet ready for prime time. The first thing is it allows you to define market shares. And market shares, economists would say, have been used way too much by lawyers for not good purposes. But there are many oligopoly models that economists look at in which market share plays a role. So if you want to tie your market back to an oligopoly model, market share pops in there somewhere. You need to define a market to get a market share. That being said, of course market shares are not the be-all end-all of the analysis.

Now a second more practical reason, based on my experience in working for the Antitrust Division and seeing how these cases play out, you know you've got smart economists on both sides. They will both come up with very good theories. These are smart guys, they wouldn't be incorrect theories. They will rely on facts that are more or less true, and it is hard for a judge who doesn't have a Ph.D. in economics and maybe hasn't

ever done an antitrust case before to sort this out. You can look at the resumes of the two sides, but you know, in this case you look at the resumes of the two experts and both are equally impressive. I don't know how you'd make a decision there.

So the market delineation test provides a set of questions that everyone agrees on. Economists and lawyers have vetted these questions. We all agree it is important on some level, the substitution between products. And here's a way to do it and here are the steps, all written out. This gives the judges a guide, and it adds some economics in the process that wouldn't necessarily be there and allows the lawyers to interpret the economics. So for that reason it is a good thing. And I'll end there, because I'm running out of time. But I'm sure I could give you some other reasons too. Anyway, that's it for me. Thanks.

MR. CONSTANTINE: What we are going to do now, maybe a few minutes of questions from the floor, and Jeff and I are going to try to get the economists to speak to each other about some of the issues. I think there actually has been very little disagreement between the three economists. At the end I'll sort of suggest some of the dirty little secrets that they all agree on, which is that market definition really doesn't make much sense, but they are forced to do it because the case law requires them to do it.

I would like Jeff to begin the questioning by posing a question to the panel.

MR. SHINDER: I want to throw out the question, and I want Professor Ordover to start on this one. How should the Guidelines deal with the potential problems caused by the cellophane trap? And *First Data/Concord* reflects, very interestingly, this issue in the following way. That is, if one way to test for the trap is for the Guidelines to do a market power screen, and if there is a potential for market power to be at work to distort the SSNIP test to adjust the price that is used for the SSNIP test, the Guidelines say use prevailing prices, and if future prices are a better indicator, use those prices instead. But what seems to be the case with *First Data/Concord* is that you had clear evidence that market power was causing the discrepancy between off-line and on-line pricing; that is apparent from the *First Data/Concord* complaint. A market power screen could have shown that and probably did show that, but perhaps—as Professor Ordover seems to suggest—it was hard to predict for future pricing in the industry, where off-line pricing would go as the Honor All Cards abolition played out over time. How should the Guidelines deal with that kind of situation and cure for the cellophane trap using competitive pricing, future pricing?

And I know that Professor Fisher has some thoughts on what the competitive price of debit is, so I would like to hear his views on this as well.

DR. ORDOVER: Just a quick answer. Obviously, it is a challenge because it is a challenge to do antitrust in dynamic markets. And whether the dynamics come from changing the set of products or changing consumer taste or anything that is out there shocking the stability of the system that we are trying to examine for the exercise of market power or the likelihood of future exercise of market power.

So in this particular case that we have been talking about, we did recognize the reduction in interchange as a result of the *Wal-Mart* settlement. We also tried to factor in the fact that some of the very large customers were actually negotiating rates for interchange that were very advantageous as compared to the average or posted rates. But taking it all in balance, we did come to the view that there was still a fair amount of, shall we say, head room, given what we thought the price path is going to be on a forward-looking basis that would enable an exercise of raising rates to merchants.

Now remember, the switch fee on the merchant sides is 5%, okay. So as Eric aptly described, when you're looking at the increase of the price of a book of 5% on a \$40 book that's a lot of money. We were thinking of what would happen if prices for switch were to go up 5-10%, so half a nickel, whatever it is. And from that perspective we were of the view—or at least I got to be of the view that, irrespective of the short-term, or even medium-term, dynamics of the interchange on the signature side, that that kind of increase would be sustainable and it would be profitable.

But I believe and I agree that one has to take that issue on board in each and every case that it comes across. Whether it is a single-sided market, one-sided market, two-sided market or three-sided market. I don't know how many sides we can come up with. This is a dynamic problem, and here it is manifesting itself in distorted prices. Elsewhere it can be manifesting itself in other ways.

So in the Guidelines we basically say try to take the best forecast of the future you can. Generally, we take the present to be the best forecast, because everything else may be guesswork. But there are circumstances like this one that necessitate very deep and lengthy thinking about the dynamics of prices.

MR. CONSTANTINE: Frank, do you want to take a shot at this?

DR. FISHER: First of all, let me make it clear, I don't actually disagree with most of what Janusz has said. And

the decision they made may have in fact been the right decision, but I want to point out a couple of things. In the first place, Jeff asked me what I thought the competitive price for debit was, and I think ultimately the competitive price for the interchange fee on debit is zero. It is zero in Canada, it was zero before Visa and MasterCard got started. There are perfectly good reasons why banks in fact make money in various ways at a zero interchange fee. But we are not there. And it is not at all obvious that after years and years of rather high interchange fees, it is not at all clear that we are going to get there quickly.

But that leads me to a further thought, which is why is the emphasis on the switch fee as opposed to the entire fee paid by the merchant? Well, uncharitably, it is because a 1% increase in the switch fee is lower than a 1% change in the interchange fee. Unless of course the interchange fee is zero, which at least at the moment it isn't. One could say, okay, even in the long run the switch fee isn't going to be zero and the interchange fee might be and then concentrating on the effects of a small percentage price increase in the switch fee will be the right thing to do. But as I said before, that hasn't happened yet, and it is not quite clear to me that was all right. Even though the result may be right.

MR. CONSTANTINE: Eric, do you want to take a shot?

DR. EMCH: One thing about the cellophane fallacy it is a different issue in a merger versus a non-merger case. The original case was not a merger case. It was a case where DuPont was accused of monopolizing the cellophane market. The fallacy was, oh, cellophane at its current price substitutes for all these other products; therefore it is a big market; therefore DuPont has a small market share; therefore they have no market power. That's clearly wrong. If it were the case that cellophane was merging with one of the other makers of plastic, you know, wrapping paper that constrained Dupont's price, even though it was above the competitive price, then maybe you would draw a larger market. Maybe that would be the right thing to do. If it were true that cellophane at its current price was being constrained by something, and DuPont was going to merge with the constraint, that would be a bad thing, so the broad market might not be a bad idea in that case.

I would like to pose a question and actually get at these issues from another direction and that is the standpoint of a differentiated product analysis applying on-line debit, and I'll pose the question broadly. When, if ever, does differentiated products analysis actually advance the argument? Because it seems to me that the *First Data/Concord* presented a situation where you couldn't construe the market broadly as both forms of debit, as Lloyd and I think is the appropriate way to look

at the market, and treat on-line debit as a differentiated product within that market. And in the context of the market shift that I think many observers predict is going to happen in the wake of the *Visa* check case see a potential for unilateral effects analysis and unilateral raise of price in that segment of the market. That being said, I could see why the DOJ and states would look at that and say a better way to go in terms of litigation strategy is to find a narrower market.

I would like to throw this question out to the panel, starting with Professor Ordovery, whether you looked at on-line debits as a potentially differentiating product within a broader market, whether that concept advances the analysis at all; and if not here, when would it ever advance the ball?

DR. ORDOVER: The Guidelines actually allow for a different approach, which is—well, the Guidelines always ask for market definition, but some people from the Division said repeatedly—including Jonathan Baker, that we actually jettison market definition if we can actually get at what Professor Fisher was talking about, directly analyzing the effect of the transaction. And I said that 20 some years ago, commenting on the Guidelines, almost precisely in those terms. So there is at least a way of thinking that gets rid of the market definition step altogether and tries to look at the differentiated model of behavior through the economics of competition. And it really tries to calculate directly, through econometric assessments, the price elevation effect.

Now, I am not opposed to that approach. I think that it has its dangers, and for those of you who are practicing in front of the Division and the FTC, I think it's important to realize that not everyone agrees that that's the way to go uniformly. So I think that one could have asked the question in this particular case whether or not this transaction would simply enable these two firms to coordinate so well as to raise the price, whatever price was at issue, to the merchants without actually going out there and trying to define the relevant market.

I do believe, as I said before, that by looking at the relevant market definition we were in fact trying to get to the similar set of issues that in, for example, toilet paper or sliced bread or beer one can ask through econometric estimations of demand functions, some sort of versions of demand functions. That was not feasible to do so here. It probably would not have gotten us anywhere, and therefore, we elected to approach it in a slightly different way.

But I don't disagree at all with the suggestion that one could have tried to attack it directly in looking at the bad act leading to bad outcome, assuming that it would.

MR. CONSTANTINE: Before I give Frank and Eric a shot at this, I'd sort of suggest that if you're going to the

agencies and you start to talk about Bertrand or Cournot, that's a good thing to do if you go to court do that.

DR. ORDOVER: You're a dead French man.

MR. CONSTANTINE: Yes, you're a dead duck. Frank, do you want to touch this?

DR. FISHER: No.

MR. CONSTANTINE: Eric.

DR. EMCH: Yes, one thing. The problem with differentiated products analysis is the Guidelines doesn't have much to say about it. It kind of says yeah, there could be a case where products are differentiated. Then the question is how much they substitute for one another, what are the closer products to other products? How do we figure this out? Well, maybe market shares are a proxy. Maybe we think the 60% market share, the next choice of those people is the 30% market share guy. But thinking that way it doesn't change the analysis much. And then the Guidelines say but maybe market shares are not a good proxy for substitution, maybe there is some other substitution mechanism which is certainly true but it doesn't give a guide for figuring out what that substitution mechanism is and how we figure out where these products are placed on the n-dimensional product space of where they compete.

You know, as Janusz mentioned, there has been a lot of work recently among economists doing merger simulation using some very sophisticated econometric techniques. And I think all economists would love to be able to use that more. Because if you do a merger simulation, the market definition becomes kind of irrelevant and the substitution matrix falls out of it if you do it correctly. The problem with that is it is very far from being accepted by the courts. So I think it is something, merger simulation which gets at this differentiated product question, is something that economists have thought about a lot but courts are a little bit behind on.

MR. CONSTANTINE: Let me take a shot at a question, and tee it up in some way.

First of all, I think the fact that these three cases sort of all occurred roughly in the same time frame and all focused on broadly the same industry, not only creates an interesting panel, but creates a very, very important moment in competition policy and competition history. But there is something about these markets and these cases which may be a bit idiosyncratic. So let me shift the facts a little bit and see whether you think there are any implications for more of a regular type of case.

Let's remember the cases a few years ago with the alleged super-premium ice cream market, you may call it. Now let's pose this hypothetical. Just like in this case, off-line debit was around 65% of the more broadly

defined market. Let's say that low-priced ice cream—which is made up, let's say, of Breyer's and Dreyers—is 65% of the market. And high-priced ice cream, super-premium ice cream, is roughly 35% of ice cream sales. And that's made up of Ben and Jerry's and Haagen Daz, and there is at least as much distance between the price of the super-premiums and Breyer's and Dryers as there was between PIN debit and signature debit. Although in my hypothetical, hypothetically at least or arguably, super-premium ice cream is of a higher quality because it's got more fat content. As we know from *The Zone* that's actually good as opposed to bad. South Beach, Dr. Atkins and everybody now understands that, as Woody Allen understood it in *Sleeper*.

But in any event, does that say to you that the implications of the analysis that you did, Janusz, and that you did, Eric, and that you did—the U.S. and the states did—in that case, is that in a merger between two super-premium ice cream companies you should disregard the 65% of ice cream sales that are comprised by much, much lower-priced ice cream?

DR. ORDOVER: No, you would use ADMs, whatever that—actually that's one of the acronyms for antitrust demands model that people use to simulate these kinds of questions. There are other approaches, all of them relying on differentiated products. One can actually estimate what Eric called the matrix of cross-elasticity effects and ask yourself, well, gee, what would be the effect of the transaction should I disregard at 65% of sales of ice cream, let's say that's just the alternative that we are looking into. And the answer could be in some cases yes and in some cases maybe not. Could be the number of people are willing to pay the 40% more for more fat and better tasting, but they are just on the cusp of what they are willing to pay. If a small increase in the price of super-premium would draw those folks to cheaper ice cream because the value of what they are getting for an extra 30-40% is not so great, that should come out of the fancy econometrics, assuming you have enough data and assuming you can do it right. You could say gee, why should we care, ice cream is ice cream. Tastes are fickle. One day they are flush, they buy better stuff. The next day they feel a little less flush. Why don't we let it go simply based on this touchy-feely stuff. We used to do touchy-feely stuff, but it is not as much fun as to do heavy-duty econometrics.

On the other hand, when you look at the cruise line merger in which I was involved, there was a big issue whether or not land-based vacations compete sufficiently with cruises as to constrain prices of cruises. Again, no econometrics, but an attempt using some economic theory to explain why there is competition and why coordination would not be sustainable. So you have a variety of approaches in differentiated products market that gets

you at the question of what constrains what and how effectively. And this is what we are after, the extent of the constraint and the diminution of the constraint.

MR. CONSTANTINE: Frank.

DR. FISHER: Well, I basically agree with that. I just want to point out a couple of things.

In the first place, in the premium ice cream question, if you did the sophisticated econometrics and you found out, so to speak, what the constraint was, please note that you would no longer care about the market definition. You would have found out what you wanted to know without going through that particular exercise.

Secondly, premium ice cream as opposed to cruises is probably particularly suitable for the econometrics because the number of product characteristics involved—what you have to do is correct for quality—is relatively small. So you have some shot at finding out what's going on.

MR. CONSTANTINE: Eric.

DR. EMCH: Nothing to add.

MR. CONSTANTINE: Let me throw out another one, which I think probably, because right now Janusz is not in the government and Frank is not in the government, but Eric may not want to touch this one.

What I hear all three of you saying is something along the following lines: With respect to *Concord/First Data* you say, look, it was obvious to us that at least in the short run and maybe even in the medium term, because of this significant price gap between off-line and on-line, the merger of two companies that had most of the PIN debit in the United States was going to cause a price increase to a significant number of merchants. And the purpose of Section 7 is to stop that. And I hear Frank saying and that's without regard to worrying about what the market definition is. And I hear what Frank is saying, once you understood, as he said, the clever trick which Visa and MasterCard had constructed under their Honor All Cards rule, that's all you need to know, and you don't have to worry much about market definition.

So in other words, my working hypothesis is that you both sort of believe that market definition is something that you do because the case law and the cases, you know, which is written by lawyers and not economists, have required you to do that, and that you'd rather actually do something else? Frank?

DR. FISHER: Okay. Well, yes, I more or less agree with that. But I will say this. I hardly know how to begin this sentence. Long, long ago, when I first got into this, and the rest of you were small children, market definition was still with us. And it was done extraordinarily badly. Sometimes it still is. At that time, however, it was

done extraordinarily badly by the Department of Justice. It was based upon word games, technical characteristics and various gerrymandering. And it should have been based on the question of what is it that constrains the defendants.

What do you have to think about in order to know that? That changed, thank goodness. That changed in 1982 with the first modern guidelines, and the SSNIP test is a way of going about that in the right way. In the context of a world in which the SSNIP test is at least correctly applied, if people understand it, market definition isn't useless any longer. It may still be unnecessary, but it is only unnecessary in the sense that if you apply market definition correctly, you're going through the same steps of analysis that you will in fact have to go through later. I think it was Janusz who said what is it that substitutes for what. And in that sense, while that's not I think the right way to, again, it is not a totally wrong way either.

MR. CONSTANTINE: Janusz.

DR. ORDOVER: Well, I agree in principle with what Frank said. I think in 1982 I sort of wrote what's called Market Definition Exercise, seems rather baffling. Ideally, if we could calculate out of some economic model, this is commenting on the brilliant Baxter Guidelines, if we could correctly calculate that effect, we would be in principal. But as it turns out that kind of economic program is harder to implement and even when you do that in the context of well-defined strategy such as those using the differentiated markets or the FTC and the DOJ apply, you will find potentially substantial discrepancy in predictions from the transaction because of the different models of demand that are being used, different restrictions on the patterns of substitutability that are being imposed in order to actually get something out of the mess of data that makes some economic sense.

So all in all, we are learning more and more about the circumstances which enable firms to coordinate. We are learning more and more about circumstances in which two firms merging will be able to internalize the negative externalities they impose on each other and elevate price. But at the end of the day, I always like to sort of start with the thing called the market or market analysis, only to organize my thinking about the issues that one confronts in any particular transaction. Although much less so than in, for example, a Section 2 case. But when it comes to joint venture or merger I think it is a good place to start. And when you go to the Division you'll still be talking markets, and when you end up in court you'll be talking markets until you are blue in the face, so whatever the realities are.

MR. CONSTANTINE: Because you have to. I mean just in defense of lawyers here, I say this is a court-imposed, lawyer-imposed regime on economists who may be somewhat reluctant. But I commend to every-

body an article by Fred Rowe, a great lawyer. I don't remember the first title, but the subtitle was the Faustian Pact of Law and Economics in which he describes market and market definition as the black hole of antitrust law.

DR. ORDOVER: I always thought of it as an economists' employment act.

MR. CONSTANTINE: I would like to invite two questions from the audience, if there are any questions from the audience.

Okay, no questions from the audience, so I'm going to exercise the prerogatives of the Chair to just sort of throw out a couple of things. First of all, I think that the panel was terrific. Again, I think there was much less disagreement and much broader agreement, just from a couple of snippets from some of the presentations.

One of the things that Eric said is that, surprisingly, there are still a lot of checks in the United States, and it's still in fact a dominant payment form in the United States. Not so up in Canada. And the reason it is not so

up in Canada is because there has been, unlike the United States, no suppression of on-line PIN debit. On-line PIN debit is a perfect and much superior substitute for checks. It simply substitutes an electronic check for a paper check. Checks in the United States clear at par. Checks in Canada clear at par. Debit in Canada also clears at par, but not in the United States. So we have still an awful lot of checks in the United States. And everybody is suffering with bounced checks and check-processing costs and MICR readers and all of that. But hopefully, as a result of the coalescing of these three cases and probably a lot of other payment systems antitrust cases, that situation will change. I think I'll leave it at that.

I want to thank the panel. I think they were terrific. Please join me in thanking all of them.

MS. ANTHONY: Thank you, Lloyd, for putting together an extraordinary panel for us. And you'll get your award tonight. Thank you. Absolutely fabulous. Thank you all, gentlemen.

Antitrust Dinner

Service Award Recipient:

Lloyd Constantine, Esq.

Constantine & Partners

New York City

Dinner Speaker:

Timothy J. Muris

Chairman, Federal Trade Commission

Washington, D.C.

MS. ANTHONY: Good evening everyone.

I would like to welcome all of you here. Many of you were here for today's terrific and really sensational CLE program, and I want to welcome you all here this evening to our dinner. We have a great program planned here this evening as well.

First of all, I want to compliment the Chairs of the panels and the panelists who put on the program today. Everyone is complimenting me, but I have to give credit for the hard work and creativity to the diligence of the Chairs and panelists for putting together what we saw today. I would like to name them and then ask you to join me in thanking them, because none of these programs are easy to put together. Everybody is so busy that we really are very grateful to each of you who take the time to put the thought and the energy and the caring into putting together a program such as we had today.

So I'm going to read off the names. Some people had to leave and are not here. But here we go: Bill Lifland, Molly Boast, Ilene Gotts; at the head table, John Delacourt, from the Federal Trade Commission, Meg Guerin-Calvert, Connie Robinson from the Justice Department, Toby Singer—terrific panelists—David Hayes, John Desiderio—thank you so much for your great work today on antitrust injury, Janusz Ordovery—he did such a fabulous job on two panels, and Bill Rooney, our colleague who chairs the City Bar Antitrust and Trade Regulation Committee, we owe him a debt of gratitude as well. And then our afternoon blockbuster panel, chaired by our very own home-grown boy, Lloyd Constantine. And his panelists, Dr. Frank Fisher, Janusz Ordovery was also on that, and Eric Emch from the Department of Justice, a fabulous panel in the *MasterCard/Visa* case.

Let's give a hand to all the panelists and Chairs. They worked extraordinarily hard to put together this fabulous program that we were able to participate in today and get lots of CLE credit for.

I'd also like to recognize—I believe that the President-Elect of the New York State Bar Association and his wife have joined us, Ken and Valerie Standard. Would you just stand for a moment? I believe you are in the

room, or that was my intelligence. All right, well you were in the room, and we hope that you enjoyed yourself.

Also, you all enjoyed the cocktail hour. I know, I was out there. I saw you. And I want to mention that the bar is open and will remain open throughout dinner for anyone who wishes to avail themselves of spirits, wine is being served. I want to thank Competition Policy Associates, Meg Guerin-Calvert and Janusz Ordovery's firm, for sponsoring our very nice cocktail hour this evening.

We all enjoyed that. And your wine at dinner this evening, which I can see you're all participating in and enjoying, is brought to you by Charles River Associates of Boston, Cambridge. And we thank them very much.

So now if I could just keep your attention—I know you're really enjoying that wine. Keeping your attention just a little bit longer, I also just want to acknowledge a couple of people on the New York State Bar staff who worked with me and who were instrumental in putting this together. Lori Nicoll. Lori just stand up for a second. She did so much great work. Thank you, thank you, thank you. I could not have gone through this without you, and I mean that. Thank you so much, you and your staff and all your colleagues in Albany.

I would like to introduce the head table before we go on to some awards. And some of these people are very familiar to you, you know them, others may be new. To my right, Jay Himes, who is the head of the Antitrust Bureau of Attorney General Spitzer's office and a member of the Antitrust Law Section and the Executive Committee of the Antitrust Law Section.

Sitting next to Jay is Ilene Gotts. Ilene is our new Secretary; she was elected this afternoon. It was a close race, but she won by a horse's nose. We are very happy to have her, from Wachtell, Lipton, Rosen & Katz.

Sitting to my left is a gentleman who I think everyone knows and needs no introduction, but he will be introduced later. My boss, Chairman of the Federal Trade Commission, Tim Muris.

And sitting to next to Chairman Muris is our very own, now-Commissioner of the Federal Trade Commission, former Chair of this Section, Pamela Jones Harbour.

Sitting next to Pamela is Lloyd Constantine, who I know none of you know at all, Constantine & Partners. He chaired that marvelous committee today and has been a long-standing member of our committee. He is on the Executive Committee, and you'll be hearing more about Lloyd later on this evening.

Seated next to Lloyd is the Vice Chair of the Executive Committee of the New York State Bar's Antitrust Section, Steve Tugander, who is an antitrust attorney with the Antitrust Division of the Justice Division here in New York.

And sitting next to Steve is David Hayes, who is down from Syracuse. He is with the firm of Bond, Schoeneck & King. And David chaired a marvelous panel earlier today on antitrust injury. David, thank you.

We have a very nice tradition in the Executive Committee of the New York State Bar Antitrust Law Section, and it's a tradition where the incoming Chair gives a token of appreciation to the outgoing Chair, on behalf of the entire Section. And that's what we are going to do tonight. Actually, this part of the program is the Antitrust Law Section's version of the Golden Globe Awards. Unfortunately, Nicole Kidman and Jack Nicholson wanted to be here to present these awards, but they couldn't find black pinstripe suits and had nothing to wear. So you'll have to settle for those of us who do.

This token of appreciation tonight is going to now-FTC Commissioner and former Chair of our Section, Pamela Jones Harbour. Ms. Harbour served for many years on the Executive Committee and is still a member of the Section. Three years ago she was Secretary of the Section. Two years ago she served as Vice-Chair, and then served as Chair until this past August when she was sworn in as a Commissioner of the Federal Trade Commission. Her term as FTC Commissioner expires in 2009.

Ms. Harbour joined the FTC from Kaye Scholer, where she had been a partner in litigation, handling antitrust matters. Prior to that she had served an 11-year tenure in the New York State Attorney General's Office as Assistant Attorney General and as Deputy Attorney General in charge of the office's 150-attorney Public Advocacy Division. She oversaw and successfully represented numerous states in various cases, including the *Reebok*, *Keds* and *Mitsubishi* cases. She argued before the United States Supreme Court, representing all 35 states in *State Oil Co. v. Khan*, a landmark case. She is a native of New York and a resident of New Jersey. A graduate of Indiana University School of Law, Pamela has a bachelor's degree from the University's School of Music.

So we miss her a lot, but I am very fortunate to have her still as a colleague at the Federal Trade Commission.

Commissioner, I present this to you on behalf of the committee and in great appreciation for your years of service, your leadership and your support in all that we do.

MS. HARBOUR: Thank you very much. Thanks, Barbara, for your very kind introduction and this beauti-

ful gift, which I understand is the traditional Tiffany clock.

It has been a great honor to participate in the leadership of this Section for the past twelve years. Lloyd introduced me to this Section MORE THAN twelve years ago when I served under him in the Attorney General's office at the Antitrust Bureau. It is truly my pleasure to have headed the Section, even though my term as Chair lasted only six short months, when I had to formally resign to take my seat on the Commission.

As expected, every day at the Commission brings new and interesting challenges. And the Chairman has been keeping us very busy this year. I constantly find myself relying on the lessons learned throughout my many years of practice here in New York. I am particularly grateful to have had the chance to work with and learn from so many talented lawyers who are in this room this evening.

I also want to congratulate Lloyd Constantine as the recipient of this year's Service Award. He is affectionately known to many of us as the father of state antitrust enforcement. It has been said that behind every great achievement is a dreamer of great dreams. Lloyd's accomplishments personify that statement.

I know that the Section will continue to do excellent work, especially under Barbara's tutelage. I thank you again for the honor of serving this Section. Thank you.

MS. ANTHONY: Thank you very much, Commissioner. It is always great to see you again and great to have you here today for the program as well.

Moving on with another highlight of this evening is our second award, which is the Antitrust Law Section's annual Service Award. This is a very, very important award which we give to extraordinary practitioners and leaders in the antitrust field.

Tonight's award is going to be presented by Mr. Larry Fox, and I'm going to ask Larry to start to walk up here while I introduce him.

Larry Fox, who is known to many of you, is a long-standing member of our Section and a member of our Executive Committee. He chaired the Section from 1990 to 1992. He is a partner in the New York office of the international law firm McDermott, Will & Emery, where he chairs the antitrust and distribution practice group. He is counsel to a diverse group of clients and concentrates his practice on antitrust trade regulation, franchising, e-commerce and distribution issues. He has a very active antitrust litigation practice, and he has litigated several antitrust cases of national significance.

Larry received his undergraduate degree magna cum laude in 1970 from Boston University and graduated in 1973 from Georgetown University Law Center,

where he was the editor of the *American Criminal Law Review*.

Now, Larry is a former partner of Lloyd's, but more importantly, he is a close and dear friend and a professional colleague of many, many years. And I think he is someone who admires and loves Lloyd a lot. And so it is with great pleasure that we turn over to Larry the job of presenting Lloyd with his award. Larry.

MR. FOX: Thank you, Barbara.

Thank you, and good evening, ladies and gentlemen. I am privileged to have the pleasure of awarding the Section's highest honor to a person most of us here tonight already know personally or by his reputation, and a person I have been fortunate to call my friend for over 25 years. Tonight the Section honors an individual who in his life and in his accomplishments embodies the ideals and the purpose for which this award has been created. The Section's Service Award is designed to acknowledge the antitrust lawyers who throughout their professional careers have distinguished themselves as leading antitrust practitioners, while also serving the broader antitrust community or this Section in a leadership position.

Prior recipients of the Section's Service Award were Milton Handler, Bill Lifland, Eleanor Fox, Barry Brett, David Boies, and Irving Scher.

This year's recipient, Lloyd Constantine, is a most worthy honoree. Like his predecessors, Lloyd's accomplishments and contributions to the development and the implementation of the antitrust laws are varied, unique and exemplary. One trait that I believe distinguishes Lloyd from his predecessors is the level and intensity of feelings and responses he invokes in people. Whether one is a friend or a litigation adversary, one matter upon which we must all agree is that Lloyd is not unidimensional. He is, in fact, a complex and often controversial figure. Lloyd has been referred to as overly aggressive, stubborn, subversive, arrogant, anti-establishment, iconoclastic. But he's also been referred to as idealistic, committed, dedicated, brilliant, and even as an antitrust guru. He was recently described in the *New York Times* as having "craggy good looks in sort of a Kennedy-esque way and speaks passionately and views antitrust through a prism of civil rights laws." His personal style has sometimes been characterized as gruff and off-putting. Indeed, one antitrust lawyer was quoted as saying, "If there is one thing I've heard people say about Lloyd it is that he has never crossed a bridge he didn't burn."

Adequately summarizing Lloyd is like trying to capture lightning in a bottle. Try as one might, it is simply impossible to do. But trying is an effort with its own rewards, for by trying we will no doubt gain a deeper understanding and appreciation for not only our hon-

oree's accomplishments but also for him personally as an individual of consequence.

From an early age Lloyd was imbued by his parents, Edna and Irving, with a value system that encouraged him to fight for the underdog with a tireless work ethic and a total commitment to each endeavor to which he set himself. Edna was a smart, hard-working woman who took over the family business after Lloyd's father passed away. And from all accounts she was a person who simply adored her son. Lloyd's father, known affectionately as Connie, was a college football star, a decorated World War II bombardier and one of the first Jewish NFL football players. Lloyd's parents were a profound influence on him.

Lloyd went on to his beloved Williams College where he played football and developed a number of life-long friendships. The institution remains an incredibly important part of Lloyd's life and his family's.

After graduating Williams, Lloyd attended Columbia Law School, and thereafter he began his distinguished legal career.

Lloyd, tonight we are proud to honor you as an advocate, an antitrust law enforcer, an advisor, a teacher, an author, a private practitioner and, of course, a leader in the antitrust bar. But most of us are already familiar with Lloyd's experience as an antitrust advisor to Attorney General Robert Abrams and as part of the transition team for Attorney General Eliot Spitzer.

We are also knowledgeable about his numerous appearances testifying before the Congress of the United States, Federal Trade Commission and New York State Assembly on competition law and policy issues. We also are well aware of his prolific writings and lecturing on antitrust related matters. He has also served as adjunct professor of antitrust law at Fordham University School of Law. We also are aware of the contributions he made to this Section as its Chairperson from 1992 to 1994, as its representative to the House of Delegates, and his continued service as a member of this Section's Executive Committee. We have also benefited from his frequent presentations at our Annual Meeting, including today where he chaired an extraordinary panel discussion on economic analysis and market definition in the *Visa/MasterCard* case.

Lloyd's distinguished career has been exemplified by the employment of his keen mind in the service of his driving desire to make a difference. For those of us who know him and his accomplishments, there can be little doubt that he has achieved this goal.

Lloyd, you have always made, and continue to make, a difference. Let me briefly expand upon this thought. While most of his law school classmates upon graduation went on to Wall Street, for the first eight

years of his legal career Lloyd worked for the Brooklyn Legal Services Office, representing indigents in civil rights and civil liberties litigation. Lloyd has described his tenure as a civil liberties lawyer by stating, "The most important work I ever did and I ever will do in law was the work I did in the civil liberties group."

After Lloyd won a class-action case against the state Attorney General on behalf of 59,000 elderly and disabled people for unpaid benefits, a representative of then-Attorney General Bob Abrams asked Lloyd to head up his antitrust bureau. To Lloyd, civil liberties and antitrust were not dissimilar, but in fact were philosophically joined. Both were about the concept of freedom. One, individual freedom; the other, commercial freedom. To Lloyd both had important influences on the lives of people. In all he does, he believes in the righteousness of his causes and proceeds with an unwavering commitment to achieve the objectives that he sets for himself. One litigation adversary was quoted as saying, "He pursues large companies with the idealistic fervor of a public defender."

Lloyd's 11-year tenure, from 1980 to 1991, as the Chief of the Antitrust Bureau for the State of New York was marked by a host of notable accomplishments. During a period of marked change in the federal enforcement climate, Lloyd set out to elevate the significance and importance of the various state attorney general antitrust offices. He accomplished this goal with such success that today the state attorney general's antitrust bureau is recognized as a third significant antitrust law enforcement force that must be considered by any antitrust lawyer counseling a client. The elevation of the importance of state antitrust enforcement in large measure can be attributed to Lloyd's early guidance and vision.

From 1985 to 1989, he was the Chair of the NAAG Antitrust Task Force and principal author of its Merger Guidelines and Vertical Restraints Guidelines and its Premerger Disclosure Compact. During this period, he also found time to argue for the State of New York and 38 other states in the United States Supreme Court in *In the Matter of Brown Foreman v. State of New York*. Although Lloyd's argument in the Supreme Court was not successful—he lost 5 to 3—Lloyd is fond of remarking, when reflecting on this experience, how very close the Court came to getting it right.

In 1991, I successfully cajoled Lloyd to make the move from the public sector to private practice. He joined me as a partner in the New York office of McDermott, Will & Emery. Between 1991 and 1994, I had the pleasure of working with him on a number of antitrust matters, including some of the formative stages of what ultimately became the *Wal-Mart v. Visa/MasterCard* antitrust case. Although I was not able to be there at the

end of this historic case, I appreciate the fact that I was there at its inception with you.

In 1994, with the desire of establishing his own antitrust boutique firm, Lloyd departed McDermott and with Eliot Spitzer and others founded Constantine & Partners, now a well-known Manhattan firm with eight partners. Lloyd's firm has handled a number of significant antitrust cases for plaintiffs and defendants, including the seminal lead counsel role for plaintiffs in the representation of over five million retail merchants in the now-landmark litigation of *In the Matter of Wal-Mart v. Visa and MasterCard*. That case was simply unprecedented in size, scope and complexity. It lasted approximately seven years, involved over 400 depositions consuming over 500 days, involved millions of documents, briefings on legal points at the District Court, Court of Appeals and the Supreme Court, and expended tens of thousands of hours of counsel, paralegals and experts. The matter was finally resolved last month in an historic settlement requiring a payment in excess of \$3.4 billion, an injunction on behalf of the merchants in the United States that is expected to save them billions more in reduced service fees, and a counsel's fee award in excess of \$220 million. According to the ABA, the settlement was the largest in antitrust history and the only one to have pitted two huge industries against each other. Not just companies, industries—in this instance, retail versus banking. I guess that means for all of us that next year's cocktail party and dinner will be hosted by Constantine & Partners.

Lloyd, I can only say from personal knowledge, you engender a great deal of loyalty, respect and friendship from those who know you. In this regard a few remarks from some friends who wish to congratulate you on this occasion were provided to me, and I would like to take this opportunity to read just a portion of a few of them.

"As Attorney General I was the beneficiary of Lloyd's brilliance, creativity, vision and extraordinary work product. As a result of Lloyd's leadership, antitrust enforcement at the state and federal level was reinvigorated and rose to unparalleled heights." Former Attorney General Robert Abrams.

"I have known Lloyd for more than fifteen years. Throughout that time Lloyd has been a vigorous articulate advocate of the antitrust principles he espoused. He has never hesitated to express his well-thought-out opinions." William Scher.

"I have known Lloyd since the very beginning of my legal career, as a boss, mentor, colleague, lawyer, teacher, confidante and friend. Lloyd is one of those people we meet from time to time who seem to be able to influence events because they are there at the time and because they want to make things better for other people." FTC Commissioner Pamela Jones Harbour.

"Twenty-two years ago as a summer intern in the New York Attorney General's Office I reported to a bureau chief who combined the sensibilities of a legal aid lawyer, the economic critique of an academic, the creativity of an artist and determination of the most hard-nosed New York litigator. Through all of his many successes Lloyd has maintained his sense of humor and sense of compassion. Lloyd, congratulations on an honor well deserved." New York State Attorney General Eliot Spitzer.

Finally, on a personal note, I am extremely appreciative of the fact that I was selected to present this award. For over 25 years of friendship, whether it be during our nights volunteering together at the homeless shelter or while walking our children to grade school together, I have come to know you not only as a partner, antitrust colleague and a friend, but I have also gotten to know your entire family. I have actually known your wife, Jan, a legal powerhouse in her own right, for an even longer period of time. Therefore, I would be remiss if I did not acknowledge that in your long and extraordinary accomplishments, the one in my view which stands as your greatest achievement is during the upheaval and turmoil of the last few years you never wavered from your recognition that the most important priority in your life is your family. Tonight I salute you not only for your commitment and contribution to the antitrust bar but also wish to recognize that this could not have been done without the support and sacrifices of your family, which were no doubt substantial. So to your wife, Jan, and children Isaac, Sarah and Elizabeth, this award honors all of you as well.

Lloyd, if you were to be characterized as a force of nature, it would be more likely that of a tornado than a summer breeze. But like any volatile moving force, you have brought tremendous change in your wake. Throughout your career, in both public and private sectors, you have demonstrated a willingness to think big, to take risks, to pursue your vision, and to exercise your creativity in using and even expanding the law to realize the ultimate objectives of the antitrust laws, the enhancement of consumer welfare.

Lloyd, you are an extraordinary antitrust lawyer and person, and on behalf of the New York State Bar Association Antitrust Law Section, I am extremely pleased to present to you the Section's highest honor, the 2004 Service Award.

MR. CONSTANTINE: Well, I think I'm going to be real brief. You're here to hear Tim speak, and so let me just do a couple of quick thank yous.

First of all, thank you, Larry. Larry has been my friend for more than 25 years—it has been 30 years, it has been 30 years. And Larry is one of those people, you know, who makes you a better person. And Larry, you

have made me a better person, but not a person nearly as good as you. And I love you very much. Thank you.

I want to thank all of you out here. It is amazing, but I think probably many—indeed, most—of you are friends of mine, colleagues of mine, worthy adversaries of mine, in some cases students of mine and in many cases teachers of mine. So I want to thank all of you as well.

I want to thank the members and the people at the firm that I work at, Constantine & Partners, an unfortunate name, but there you have it. We've had an incredible ride at the firm, and I think it is just beginning. We started this idea that antitrust at a high level could be practiced in a small, intimate and collegial setting. We launched off on that ten years ago, and it has been an absolutely incredibly marvelous ten-year ride. And I want to thank all of my friends and colleagues at the firm for coming here tonight and for everything they have done.

Most importantly, I want to thank my family. My parents, my wonderful wife, Jan, who is the first and best antitrust lawyer in the house. An antitrust lawyer way before me in the Commission. And my three marvelous children Isaac, Sarah, Elizabeth. Everything that I've ever done, everything that I am, everything that I ever will be is because of them and is for them and for their love. So thanks everyone.

MS. ANTHONY: Lloyd, a heartfelt congratulations from everyone here to you. We love you. Congratulations, and nicely done.

Larry, beautifully done.

Okay, everyone, enjoy your dinner. We are going to eat right now and then come back in a few minutes to introduce the Chairman, and we'll go from there.

MS. ANTHONY: Good evening again, everyone. We are going to begin the final part of our program with our keynote speaker. We are joined this evening by the Chairman of the Federal Trade Commission, Timothy Muris. I am going to introduce him and then we are going to have a question-and-answer period. I get to ask some questions, my boss here gets to give us some answers, and then we are going to open it up to all of you. So that's the format for this evening's keynote talk.

Tim Muris was sworn in on June 4th, 2001 as Chairman of the Federal Trade Commission. President George W. Bush named Mr. Muris, a Republican, on April 26th, 2001, and he was confirmed by the Senate approximately one month later, on May 25th, 2001. It was not a very long, drawn-out proceeding.

Mr. Muris has held three previous positions at the Commission. He was Assistant Director of the Planning Office; he was Director of the Bureau of Consumer Pro-

tection; he was also Director of the Bureau of Competition.

CHAIRMAN MURIS: Not at the same time fortunately.

MS. ANTHONY: Prior to returning to the FTC in 1981, he served as Deputy Counsel to the Presidential Task Force on Regulatory Relief, headed by then-Vice President Bush. After leaving the Federal Trade Commission in 1985, Mr. Muris served with the Executive Office of the President's Office of Management and Budget for three years. He then joined George Mason University School of Law as a Foundation Professor in 1988 and was interim Dean of the law school from 1996 to 1997.

He has published numerous books and articles on antitrust, consumer protection, federal budget issues, regulation and contract law. He was also of counsel to the law firm of Colliers, Shannon, Rill & Scott, and Howrey, Simon, Arnold & White. It is with great pleasure I introduce Chairman Timothy Muris.

CHAIRMAN MURIS: Thank you.

MS. ANTHONY: Welcome to New York, Mr. Chairman. Nice to have you here.

CHAIRMAN MURIS: It is a pleasure to be here. A lot of old friends are here. It is nice to see Lloyd honored.

MS. ANTHONY: Great. I'm going to begin with a couple of general overview questions.

Now, you happen to be the only person in the history of the Federal Trade Commission who has headed up both of the Commission's enforcement bureaus, the Bureau of Consumer Protection and the Bureau of Competition. You have also served as the Agency's Chairman. What lessons do you derive from this unique combination of experiences about the appropriate role of the FTC as a competition and consumer protection agency; and how has each experience altered your views about what the FTC should seek to do? For instance, would you have defined the FTC's appropriate role back in 1985, when you left the agency, in the same way that you would have defined it in June of 2001 when you came back as Chairman, or let's say today, 31 months into your tenure as Chairman? And there are no lifelines.

CHAIRMAN MURIS: I like to think that as I get older I get wiser, but I guess I'll let other people judge that. My view of what we do is: We have a market economy, and the debate is largely complete—except in areas like health care—about whether the market is the appropriate way to manage and organize the economy.

I come out of the law and economics tradition, and with a market economy you need rules and the rules that the FTC enforces are so simple, we don't even think of them as rules anymore. They are rules that say don't

commit fraud, don't break your contracts, have honest advertising, don't collaborate with your competitors in an anti-competitive way. Those rules are very important.

One of the things we saw with the transition from state economies to market economies is that it couldn't happen overnight. We have centuries, in Anglo-American tradition especially, of developing these sensible rules. In a modern economy, you need a government agency to enforce these rules, and that's what we do.

The second aspect that's important in what we do is: We are not just a law enforcement agency. A modern competition/consumer protection agency needs to use all of the tools available to us to influence policy. Besides cases, we do a lot of what we call advocacy, where we go before states and other federal agencies to be an advocate for competition. We spend a lot of time, for example, trying to talk various states into not requiring lawyers to be present at all real estate closings. We've mostly had good luck, although the State of Georgia recently told us to take a hike.

One thing Bob Pitofsky reinvigorated—and I do think there is enormous consistency between Bob's chairmanship and mine, although an obviously big difference is that he had to deal with the merger wave and I didn't—is the FTC looking at detailed issues in the economy and reporting on them. We have had two sets of hearings where we have had 24 and 27 days of hearings, one on intellectual property and one on health care. We released a very useful report on intellectual property, and we are going to release a report this year on health care. We are trying to be the leader in what Bill Kovacic, our general counsel, has a nice phrase for: competition policy research and development. I think that's a very important role. We are trying to be second to none in the world at that role.

MS. ANTHONY: I have another general type of question for you, and this one goes to legacy. You're the fifteenth person to serve as Chairman of the Federal Trade Commission since the Reorganization Act gave the Chairman strong powers fifty years ago. Each of your predecessors probably hoped to make lasting contributions to the development of the agency and to the formulation of competition policy and consumer protection policy. Ten years from now, 2014, fast-forward, when commentators write about the Muris FTC, what accomplishments do you hope will be regarded and will remain durable contributions of policy making?

CHAIRMAN MURIS: I hope people look at it across history. The FTC started over again in 1970, after the Kirkpatrick and Nader reports. And it didn't start over again completely in 1981, but it did start over again substantially on the consumer protection side. The FTC was engaged in this business of trying to write new rules for many industries, and that was surely an inappropriate

task for people who are un-elected. We substituted for that fraud cases, and we are trying to be the premier agency in the world that tries to organize going after fraud, not just domestically, but cross-border. Surprisingly, it seems ridiculous now, but it was wildly controversial in 1981 that the FTC would bother with fraud. That's now the bread and butter of our consumer protection mission, although we do a lot more besides fraud.

On the antitrust side, a lot of debates that have been settled now existed in 1981. There was still a debate going on about the role of concentration: Was concentration itself a problem? It was only 1979, two years before we took over, when the national commission in the Carter Administration called for no-fault monopolization. There was a debate about the appropriate role of economics, whether other things should count. There was a debate about what should be the bread-and-butter of antitrust. I think those debates are over, and economics is what antitrust is all about.

The most important cases, the bread-and-butter of antitrust work, is horizontal restraints and horizontal mergers. That doesn't mean there aren't other good cases, and we have had probably the most aggressive use of Section 2, in certain ways, since the 1970s. I hope it comes to a better end than what happened in the 1970s.

So I hope that we are viewed as trying to build on what I thought was the extremely good work that was done by Bob Pitofsky, who was building on good work done in the previous administrations in both antitrust and consumer protection. I like to say that we are a bipartisan island in sort of a sea of contention in Washington. For the most part, in Congress, I think people view us that way. They view us as one area where they don't deal with partisan bickering. I think it has worked out very well.

Our partners in the states are extremely important to that end in both competition and consumer protection, although the states put more resources obviously into consumer protection than they do into antitrust. I would hope that we are viewed as improving what the Commission does, as moving the Commission to be the leader in the world on many of these issues that I've talked about, and I hope that it continues after I leave.

MS. ANTHONY: You know, there are two things that people have mentioned to me tonight. One is the Do Not Call Register—we are all antitrust lawyers, but we are consumers too—and also, the weight loss initiative. Do you want to say a couple of things about those?

CHAIRMAN MURIS: I am repeatedly asked by reporters—and no one has heard this because it is a boring story, as I'm an academic and thus fairly boring—What is the genesis of Do Not Call? One of the reporters

actually told me there must be some housewife in Iowa or Missouri who led a national movement.

The truth is, when I came to the Commission, under Bob Pitofsky, privacy had become a major issue, which was commendable. But when I was doing my round of courtesy calls on the Hill, privacy was defined as whether you supported notice and choice legislation on the Internet. I thought that was very odd. I'm dating myself here, but there's an old Peggy Lee song called "Is That All There Is?"

So, Howard Beals and I, in the summer of 2001, sat down and we thought the focus that led to that legislative proposal was information collection. We spent a lot of time looking at privacy issues, and we thought what bothered people more was information misuse. The misuse can range from fear of stalking, which is a big issue—there have been some privacy violations that have led to people being stalked, and even people murdered—to economic injury such as identity theft, which is a much bigger problem than I had thought or most people had thought. A survey we released last summer showed how big it was. There are also the interruptions of your daily life. That led us to that intellectual perspective.

You can see why a reporter doesn't want to write this. It is too long and boring for one thing. But that intellectual perspective led us to the proposed national Do Not Call Registry. Its implementation turned out to be much harder than I had envisioned—politically, practically and legally—but I think we are through most of the hurdles. There are 56 million phone numbers registered; that's phone numbers, not people. But there has been extremely good compliance.

Just out of curiosity, how many are signed up in here? A lot. Now we are working on several enforcement targets.

Just to say a word briefly about weight loss, after a big dinner. I had a very interesting meeting with the Magazine Publishers Association of America here in New York. It was tough on both ends. We have what I think is a very simple proposition, which is: You shouldn't run obviously false weight-loss ads. In fact, many media do not run them. I've met with publishers of major newspapers and magazines; they don't run these ads, but they don't want anyone to know they don't run these ads because they are afraid the tort lawyers will sue them for something. Some of the magazines do run them. I was asked, you know, are you going to sue us? I said I was more likely to go on Oprah with a copy of their magazine, which I think would bother them more, quite frankly, than a lawsuit.

But our effort is not about lawsuits. I think it's about what Spike Lee used to call "doing the right thing." In terms of our resources it is a fairly minor initiative, but

we have had a fairly good response. One very good thing that happened—and the staff issued an opinion letter saying this was okay—was that the Electronic Retailing Association, working with the Better Business Bureau, has now set up a very quick review system of infomercials. It doesn't just involve weight loss, but will try to screen out obviously false infomercials. I think that's all to the good. Self-regulation has been extremely important in the advertising world, and I am glad that this effort has encouraged some more beneficial self-regulation.

MS. ANTHONY: Great. Let's turn to mergers, which is exciting. There have been recent situations in which the Commission has decided not to challenge acquisitions in markets where concentration levels were at high HHI's. The Commission and the Antitrust Division have also announced there will be a merger enforcement workshop in February, and the agencies have released data on past mergers.

A couple of questions. Is there likely to be any consideration of modifying the Merger Guidelines to establish higher concentration thresholds for challenging future acquisitions? And what does the data reveal about agency practice?

CHAIRMAN MURIS: Let me say a few things about the Merger Guidelines in general, and then let's talk about the concentration issue.

First of all, I think more guidance is useful. Now, that doesn't mean necessarily changing the Merger Guidelines, but the more guidance that we can give, the better. We are about to release data, next week I hope, which is going to be more revealing than the data that we just released. For better or for worse, the FTC—perhaps because of the Commission form—has the ability to publish some very revealing data. We are going to release for fiscal '96 through fiscal '03 the same kind of data on HHI's that we just released. But we are also going to have information on cases where a second request was issued and the case was closed. We are also going to have information on the number of significant competitors, so you can see, not surprisingly, that we almost always sue in 2 to 1 cases, and we rarely sue in anything over 5 to 4, although it is somewhat industry specific.

We are also going to have information on customer complaints. What happens if there are strong customer complaints? In fact, I think there are 51 cases in this sample and the Commission, not surprisingly, sued in 50. (I can't tell you the one we didn't sue, but it was sensible if you understood the reasons. Actually, it was before I was there, but I have looked at memos.) We are also going to release data on hot documents—a narrow definition of hot documents, where there is a prediction of anti-com-

petitive impact, like a price increase. Not surprisingly, there again the Commission almost always sues.

So back to the question of concentration. I've been a little surprised by some suggestions, although they haven't come from people who are all that knowledgeable about antitrust. Jim Rill's change in the 1992 Guidelines was the appropriate change about concentration. He said that concentration is just a starting point. He made it clear that the thresholds in the Guidelines didn't have any all-encompassing impact. I think people who practice know that. If you look at the data we released, I wouldn't know how to change the numbers, if you wanted to change the numbers. A change in the numbers could give the wrong signal. It would imply that the numbers are more important than in fact they are.

MS. ANTHONY: Thank you. On to some other subjects. State action, which I know is a priority. The FTC staff has recently released a report on state action. Do you agree that some courts have incorrectly applied that doctrine?

CHAIRMAN MURIS: Yes. Not surprisingly, I agree with what's in the state action report from the staff. The state action doctrine, if you think about it, makes sense in that the states can displace competition. It also makes sense that they really have to be clear that's what they are doing.

There are some courts that have read the foreseeability test that comes out of the cases, in the way that tort lawyers and tort judges read *Palsgraf*. (I guess if I'm in New York it is appropriate to talk *Palsgraf*; you guys remember *Palsgraf* from your law school days.) They are applying a standard of foreseeability in almost a tort sense and not thinking what the legislature really intended in place of competition.

There is a Fifth or Eleventh Circuit case, I forget which, that essentially allowed two hospitals to merge based on a very general statute allowing certain regulation of hospitals where there is no indication at all that the state had given any serious consideration to allowing anti-competitive mergers.

The state action cases are all over the place. We have several state action cases either under investigation or in litigation, and we are always looking for amicus opportunities. We did file one in a state action case in Tennessee where the District Court had for some reason decided that state action in antitrust should look like state action under the Fourteenth Amendment. We thought that didn't make sense, and so said it in a brief to the Sixth Circuit. So we have a clear view on that.

It is important that we as antitrust lawyers recognize that public restraints can be worse or at least just as bad as private restraints, and that's why we are putting so much emphasis on state action and *Noerr-Pennington* as

well. This was true the last time I was at the Commission—we brought the *Ticor* case—and it is true this time as well.

MS. ANTHONY: Well, if you think some courts have incorrectly applied the doctrine, what would you recommend to the courts and what would you recommend to clarify that?

CHAIRMAN MURIS: I think the doctrine needs to be tethered more to its intellectual moorings (and this is something we couldn't do at the FTC obviously). Justice Scalia noted there are some contradictions in *Parker v. Brown* itself. A major problem in *Parker v. Brown* is it turns out that *Parker* was a case with very strong spill-overs. The people in California were, in essence, taxing the people in the rest of the country. There are very few cases like that. You can have a state action doctrine and still say that a state can't do that. In fact I think if a case like *Parker* came up again, it might come to a different result. Unfortunately, when *Parker* came it was the first one. Almost all the cases don't involve these so-called interstate spill-overs.

The most important issues are to make clear that the state has a clear articulation, and to make clear that, in those areas where active supervision is required, the supervision is something more than perfunctory and cavalier. Our cases are addressing both of those issues.

MS. ANTHONY: Let me turn to a recent Commission decision, Mr. Chairman. Recently the Commission reversed an ALJ ruling in the *Schering* case and held that pharmaceutical companies engaged in patent infringement litigation violated the antitrust laws by entering into settlement agreements under which the patent owner and a generic competitor agreed not to market a rival product until a set date, and that date was more than four years in the future, but five years earlier than the expiration of the challenged patent. The parties, however, contend that this was a bona fide settlement of the litigation, and it benefited consumers by shortening the life of the patent.

Now, my question to you is: What factors led you to conclude that the challenged agreements were not reasonably ancillary to the pro-competitive objectives of facilitating settlement of patent disputes?

CHAIRMAN MURIS: Let's put the drug aspect of the case in context first. Bob started doing these investigations about four or five years ago. We have been on a 45-degree angle over the last four or five years in the increase of resources we spend in this area. It is the single largest resource user outside of horizontal mergers in the Bureau of Competition. We have many investigations. There are only a few cases in the agreement area that Bob pursued, probably because of the potential treble damage exposure, and we haven't found many more

like that. Most of the cases we have brought—and we have had very good success working with the states here—are unilateral Section 2 cases where the branded drug company is manipulating the so-called Hatch-Waxman system to deter entry.

Schering was interesting both in terms of doctrine and in terms of the specific facts. In terms of doctrine, we said that it is a Rule of Reason area, and the circuits are split on this issue. We also said that this is an area where you can use direct economic evidence of the unique impact of generics to find a market without going through the indirect method that we have to use in most cases of trying to define the metes and bounds of a product market.

In terms of the specific facts, it was pretty clear and essentially conceded by the parties that if we could show that the payment was a payment for entry delay, then that was anti-competitive. Tom Leary, who wrote the opinion, working with our general counsel's office, did a masterful job and produced a de novo review of the facts, which is what most of the opinion is about. The very large payment was the branded company sharing some of the profits with the generic that would continue to be made in the absence of generic entry. I'm sure they'll appeal the case, and we will see what the courts will say.

The Supreme Court has just this week asked for the government's views in the Sixth Circuit patent settlement case for which cert had been filed. Obviously, the FTC's position is in *Schering*. I'm not here speaking for the Antitrust Division, so we'll see what the government says.

MS. ANTHONY: In these cases, patent validity is always an issue or something that we wonder about. So let me ask you what factors led you to conclude that it was unnecessary to rule on the merits of a disputed patent, to assess whether the settlement agreements resulted in a longer or shorter period of patent exclusivity?

CHAIRMAN MURIS: It is certainly possible, as Tom wrote in that opinion, that the uncertainty over the potential outcome could lead to a patent settlement. Settlements are good things, which is one reason that we were extremely reluctant to apply a per se standard. But I think if you have a payment that you conclude is a payment for delay, you can take that uncertainty as given and say that you can't use a settlement to share some of these large profits in the drug area with your generic competitor for delay. That's what we said. We also said that we wouldn't be afraid to deal with patent issues if we had to. I don't want to say anything more about the patent issues because we have an appeal to us in a case about which we are going to hear oral argument on

March 10th, and this is one of the issues: the Commission's role in deciding patent issues.

MS. ANTHONY: Well, let's turn to another case, the *Trinko* decision just came down recently. Do you want to comment on that, and in particular what do you think *Trinko* says with respect to industries other than telecommunications?

CHAIRMAN MURIS: *Trinko* has a lot to say about Section 2. A problem I've always had with antitrust lawyers is they tend to over-read individual cases, and many people are doing that with *Trinko*. Lloyd and I, when we were on the *BNA Antitrust Trade Regulation Review Report*, would often see people extrapolate from a sample of one.

But I do think *Trinko* says a lot about the modern antitrust consensus. There is no dissent. It is impossible to read the discussion of essential facilities without seeing Justice Breyer's hand for example. Justice Ginsberg as well—not as much as Justice Breyer, perhaps—but she has clearly been part of the modern antitrust consensus, and both are hardly judges who could be said to be pushing the boundaries of antitrust law in a way that's not sensible. That opinion, its discussion of essential facilities and its discussion of the need to be tethered to economics, is completely within the modern antitrust consensus. That's the most important part of it.

Some people are reading it as saying it means necessarily this or that for other cases. I think that's where some of the over-reading comes in.

MS. ANTHONY: Let's turn to the intellectual property report that the Commission recently issued, and a couple of questions in that area.

This report makes a number of recommendations designed to better balance the goals of patent and competition law. Now, among the recommendations was one for legislative change to assess the validity of a patent on the basis of a preponderance of the evidence rather than clear and convincing evidence. Can you think of any recently litigated cases in which this change in legal standing would have changed the outcome of the litigation?

CHAIRMAN MURIS: Now that I've had a little experience as a judge, I can appreciate this even more. Judges are supremely reluctant to explain that they are deciding a case based on the burdens. I do think, and we had a judge testify before us, who said that, given the presumption of validity of the patent office and given the standard, it is two strikes against someone challenging a patent. The National Academy of Sciences is issuing a report soon that I think will say some things similar to what we said. We said this is not a system that's fundamentally broken, but we are proposing more than tinkering.

There are too many patents issued too cavalierly. In some industries patents are causing major problems. We said that we need to take some steps to restore what we consider a more appropriate balance between competition policy and just granting patents. The PTO is trying to do a good job but they are understaffed and overwhelmed by the increase in patents. Several years ago they had the idea they were supposed to be customer-oriented, which meant they were supposed to grant patents. I don't think that's their statutory duty, and that's not how they do things now.

Between our report and the National Academy of Sciences report, there will be a healthy debate about the patent system.

MS. ANTHONY: Mr. Chairman, I've got one last question. I'm going to ask about one of your favorite cases, *Three Tenors*, and then maybe we can throw it open to the rest of the gathering this evening.

CHAIRMAN MURIS: Sure.

MS. ANTHONY: In that decision the Commission suggested that it may not be necessary to prove that the respondents have market power in the defined market if there is evidence of actual anti-competitive effects resulting from the challenged conduct. Now, what type of evidence may be sufficient to show actual anti-competitive effects attributable to the conduct of firms with a combined market share below that which would normally be required to prove that they had the ability to raise prices or otherwise exert market or monopoly power?

CHAIRMAN MURIS: *Three Tenors* is on appeal in the D.C. Circuit. Polygram's brief is due next week, and it is obviously going to get decided in the D.C. Circuit. It is interesting to see the reaction. When I talk to people who are plaintiff-oriented, they think it is much too tough a standard on plaintiffs. Those who are defense-oriented think it's much too tough on defendants.

What the opinion does is take the modern Supreme Court movement, which began in *BMI*, away from simple per se and Rule of Reason boxes. We say that the Rule of Reason is a continuum and you can decide cases without a full Rule of Reason. We try to put some structure to that sort of case.

Schering is different in that it was not a truncated case at all. *Schering* was a case that involved a full Rule of Reason, but using direct economic evidence. If you have conduct that involves such basic things as agreeing with your competitor not to advertise and not to discount price, then a more summary approach is appropriate. One of the interesting things about the case, even if you disagree with our approach, is that there was a natural experiment. In 1994, when the second *Three Tenors* album came out, they didn't have these restraints, and there was enormous competition between the two. Con-

sumers benefited. When the third album came out they didn't have this competition. Even if you had to show hard evidence, the second part of the opinion has an alternative way to explain the result. Thus, we had what you don't often have in an antitrust case. You have virtually the same setting with and without the restraints. So I think it is a very easy case in terms of the result.

But what exact analysis the courts will apply, I don't know. We have done what the Commission should do, which is try to help guide the development of antitrust law, and we will see how that works in the circuit court.

The Solicitor General's brief, which was written by the Commission with almost no changes from the Antitrust Division or the Solicitor General, in 1984 in the *NCAA* case, really began this analysis. The brief took *BMI* and said this is the way you should approach things. After 20 years, *Three Tenors* has an improved way to do this. But it certainly is built on what began with *BMI* and what began with the *NCAA* brief and was continued in the *NCAA* opinion. I also think our opinion deals appropriately with the court's concerns in *California Dental*.

MS. ANTHONY: Thank you, Mr. Chairman. That concludes my questions. We are now opening it up. Any questions from those of you in the audience tonight?

CHAIRMAN MURIS: Yes.

AUDIENCE MEMBER: There was a debate today where the current head of the Bureau of Competition spoke along with Greg Werden from the Justice Department and also David Scheffman, former head of the Bureau of Economics. And the debate there was about the usefulness, the validity, the issues related to unilateral effects and merger simulation analysis versus coordinated effects. Where do you see that going in terms of, I know it has been an issue, as to whether the agencies have focused too much on one, not enough on another; what are your thoughts?

CHAIRMAN MURIS: Having read several iterations of all three sets of slides over the last month, it is obviously an issue I pay a lot of attention to. There is a lot of agreement, even though it was styled as a debate between Greg and Luke on one hand and David on the other. What we are talking about is the use of merger simulations to try to measure unilateral effects, particularly in consumer products mergers where you can get scanner data from the supermarkets.

I think Greg and Luke made a very interesting point. A lot of the work that Greg and Luke did was the kind of work academics do, and they were developing an academic approach. Probably in most cases, the approach is not ready for the government to base decisions on. Much of what we see from the outside is not very well done.

Let me give you some problems. I mentioned in a speech a year ago, in my shot across the bow to the economic consulting world, that the good consultants wrap themselves in the facts of the case; but too many of them are into modern game theory alone which is divorced from the realities of real world markets.

One problem in these mergers is the data is retail and the merger is wholesale. You will often see the variation in retail prices doesn't correlate with the variation in wholesale prices. Dan Rubinfeld, who is a proponent of this technique, came in on a case that he's going to write up publicly and he saw that difference. So he didn't do any simulations, but he talked us into using good economic analysis with lots of facts and lots of statistical analysis without a simulation, because a simulation was inappropriate.

A second problem is the Bertrand assumption that drives these models. Bobby Willig and I have debated over years about dead Frenchman. The Bertrand assumption and the Cournot assumption are often used and the authors are both long dead. It is odd, after economists had rejected them for decades, that they surfaced again. The reason they surfaced is because, as Mike Scherer once said, you can use their assumption and give the problem a good bash with calculus and with computers. But the Bertrand assumption is a very simple assumption that assumes a price increase because of the nature of the way the model works. You need to have an industry where competition is driven essentially by price and price alone. For a lot of consumer goods, that's not a very good description.

Greg has a very good affidavit in the bread case the Justice Department did. He has a lot of evidence that the Bertrand assumption fits the bread industry. I've done a lot of consumer goods work, and it doesn't fit many consumer goods.

The economic consultants are quite concerned about my views. I think the simulations have their place, but I think they have been significantly overused, and there was agreement between Greg and Luke and Dave on that proposition.

AUDIENCE MEMBER: A few years ago you published, before you were Chairman, a critique of the 1997 amendment to the Guidelines regarding the so-called efficiency defense, and I recall the critique got into application of those guidelines and mergers, hospital mergers, Long Island mergers. I'm curious to know whether you've seen any mergers that have come along since you've become Chairman where efficiencies was a major issue and whether your thoughts on efficiency so-called defenses come into play in terms of your enforcement judgment, or if not, whether you're looking for a case to apply your thinking on efficiencies?

CHAIRMAN MURIS: We had a merger efficiencies roundtable in December 2002, which Ilene spoke at, and she actually has written the most definitive, exhaustive footnoted paper about efficiencies. Is it not published?

MS. GOTT: Yes, it is, by Fordham.

CHAIRMAN MURIS: I gave opening remarks at the roundtable and those remarks are posted on our Web site. What I said there is we have a serious chicken-and-egg problem. You all, when you represent people in mergers, don't bother to bring us efficiency defenses because our lawyers don't pay any attention to them, and they don't pay attention to them because they almost never see a sensible efficiency defense. It is hard to know how to break that problem. I've seen only two cases turn on efficiency; none in the 31 months since I've been Chairman. They were both when I was Bureau Director. One was public, which was *GM/Toyota*, which had a terrific efficiency argument. *GM/Toyota* is an interesting example of the modern consensus. It was wildly controversial at the time, and when people think about it now they wonder how could we have wasted so much time thinking about it. It was approved 3 to 2. I remember, when I gave a press conference, that it was a big story because it seemed so controversial.

The other case was a merger that was nonpublic, and it was a merger where somebody had a good history of taking over plants and lowering costs. My main criticism of the government, in an article I wrote, was that when the government got to court it pretended that all the statements it had made publicly about why efficiencies count hadn't been made; then the government really attacked efficiencies.

On hospital mergers, the evidence on the wave of hospital mergers in the late 80s and early 90s was that many were efficient. The hospital mergers in the late 90s, some of them, not all of them, have caused market power problems when there has been very little effort at synergies or efficiencies. We have a hospital merger retrospective, but that's another tale.

AUDIENCE MEMBER: You've noted that you haven't played the same merger wave that Pitofsky's Commission did. Assuming that you do face such a wave while you're still Chairman, will we notice any difference in the vertical or horizontal area in the way your Commission approaches that wave than the way it was previously approached?

CHAIRMAN MURIS: There are differences at the margins in terms of deciding cases. One of the interesting facts about 20 years ago when I was bureau director was that we used a primitive form of merger analysis. We did things we would never do now. We challenged mergers that we would never challenge now. Through hundreds and hundreds of merger evaluations, we have

gotten more sophisticated. It is still too fact-bound in the sense that it is hard to draw more general rules.

We have challenged vertical mergers. Most of our vertical mergers, and those when Bob was Chairman, involved various government regulations. Those problems are particularly serious. I'm not a big fan of the raising rival's cost theory outside of the government context, but the government is obviously very big in the United States. You can have very good cases with a vertical merger, when it enhances the merged firm's ability to manipulate some sort of government process. We have talked about that in our public statements.

Mergers generally are picking up. I don't think we are going to have a 1999-2000 style merger wave. It doesn't look like we are going to have a bubble in the stock market for one thing.

Although Bob's tenure was driven by the merger wave and mine is not, I really think there has been very significant continuity. If you look at the data we are releasing next week, there are a lot of outliers in percentage terms. For example, there are 2 to 1 mergers the Commission approved. I think they were all in Bob's tenure. Some of them were public; e.g., parts of McDonnell Douglas/Boeing. Some of them are nonpublic.

When we approved the cruises merger, we said that there were seven non-hospital mergers (you have to treat hospital mergers differently given the government's record) that had concentrations as high or higher during Bob's tenure that he allowed to go through. The concentration was quite high in the cruises case. There was a very large fringe at the market boundary but it's defensible to define cruises—and Barbara's office did this and did a very good job—as a market. It is clearly a different kind of market, given that half of cruisers are first-time cruisers. If we had to litigate, there would be a very serious market definition argument.

Thus the predictions I made about continuity at the beginning have been borne out. We have tried to build on the good work that Bob did in merger remedies and in substance and in consumer protection. We are having our 90th anniversary of the Commission in September. Dick Posner, who is an FTC alum, is giving a dinner speech. The next day Bob and I are doing a luncheon where we are going to talk about our agreements and disagreements. The former are going to be much bigger than the latter.

AUDIENCE MEMBER: One of the more controversial issues out there, now embodied in the *3M* case, is can price bundling above cost price bundling ever lead to antitrust liability? I was wondering if you have a view on that?

CHAIRMAN MURIS: I'm recused from the case, so let me not talk about it. I will say that one important

point to understand is that bundling is ubiquitous in our economy. I'm only mildly exaggerating, but most purchases you make, except for the simplest purchases, are bundled in some way. That's point one.

Point two: There is nothing that a modern economist with modern industrial organization will bless or condemn uniformly, including bundling. It will be interesting to read the government's brief, which I haven't read and I won't be able to read until it is public.

I am suspicious in general of attacks on price competition, very suspicious. I take a hard-line view on predatory pricing cases. Before I got to the government, at the ABA in the summer of 2000, I did criticize the *American Airlines* case. Although the government did re-do the case in a way to try to address some of the objections that I and others had, including the point that the case appeared to tell the incumbent to just cede market share. Because competition exists in so many industries in terms of entrants causing price wars, I thought consumers were going to lose a lot from a rule that forced incumbents to cede market share.

The government in its Tenth Circuit brief said that wasn't what it was arguing, and Greg Werden has written an interesting paper—I obviously don't know the case as well as he did—that the Tenth Circuit really didn't confront the arguments that the government was making in its brief one way or the other. So I am concerned in general. I don't want to talk about 3M, because I am recused, but I am concerned in general about attacks on price. I think there is a very high standard to bring an antitrust case in that area.

MS. ANTHONY: Any other questions for Mr. Muris?

AUDIENCE MEMBER: I have a question. You talked about the FTC's IP study, and I'd be curious about your reaction to the criticism that's heard sometimes today that our IP regime risks turning us into a society where more and more we are required to ask for permission and pay for the right to use information that's available in society.

CHAIRMAN MURIS: Certainly the implication of our criticisms is consistent with that. I wouldn't phrase it exactly like that. But I met with about a dozen of the leading attorneys in the patent bar—privately, they are extraordinarily critical of the system and, publicly, many of them are willing to say that it is just flat-out too easy to get patents.

In some industries, software for example, you have an enormous number of patents. We have investigations of firms now called non-practicing entities. Antitrust can only be a solution in a very extreme case. Some firms are in the business, not of making anything, but of buying patents and enforcing them. In an extreme case you can bring a *Noerr-Pennington* sham case. We have a few investigations. I have no idea how they will turn out. Antitrust though is not going to be the solution to this problem.

I do think that the patent system is extremely important. The protection of intellectual property is one of the strengths of our economy. I want to make that clear. But the point of our report was that we need to restore more of a balance in the sense of avoiding bad patents.

One of the examples we like to talk about is: Henry Ford had to beat a patent where somebody said if you put an internal combustion engine on top of a carriage that the combination of the two was patentable. It took him a while, but the courts said that was obvious. Under current standards of obviousness, I'm not at all sure how that would work out. One of our favorite examples is somebody took a jack-o-lantern and put it on a trash bag, and the combination of the two was said to be not obvious. It is easy to come up with examples to poke fun at any legal system, but there are lots of problems in the way the Federal Circuit applies that particular test, and there are many other problems that we pointed out in our report.

We sent over copies to every judge on the Federal Circuit. Judge Newman is an old friend and colleague from George Mason who believes in applying economics. Judge Plager is another old friend and colleague with similar views. What we are saying is about patent quality: some patents that are issued, should not be issued under sensible standards. Patent quality has deteriorated in the last 10 to 20 years in a way that should cause us concern.

MS. ANTHONY: It is 9 o'clock, and that will be our last question.

Mr. Chairman, on behalf of this entire Section I want to express our appreciation to you for speaking with us this evening and to thank you so very much for your extraordinary and substantive candor. Thank you very much.

(Whereupon, the Annual Meeting of the Antitrust Law Section concluded.)



2005

New York State Bar Association

ANNUAL MEETING

January 25-29, 2005

New York Marriott Marquis
New York City

Antitrust Law Section Meeting
Thursday, January 27, 2005